# H.R. 1415, THE VETERANS HOME LOAN MORTGAGE INDEMNITY ACT OF 1989

## HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND MEMORIAL AFFAIRS

OF THE

## COMMITTEE ON VETERANS' AFFAIRS
## HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

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# H.R. 1415, THE VETERANS HOME LOAN MORTGAGE INDEMNITY ACT OF 1989

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**Tuesday, April 18, 1989**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS,
COMMITTEE ON VETERANS' AFFAIRS,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 11:05 a.m., in room 334, Cannon House Office Building, Hon. Harley O. Staggers, Jr. (chairman of the subcommittee) presiding.

Present: Representatives Staggers, Jones, Payne and Parker.

## OPENING STATEMENT OF CHAIRMAN STAGGERS

Mr. STAGGERS. The subcommittee will now come to order.

It is a unique opportunity for me to be chairman at this time. Last year our able chairman, Marcy Kaptur, got this particular piece of legislation which we will be dealing with today through this subcommittee and through the full committee. I voted against that measure last year, basically because of some of the opposition of the people sitting in this room today. So I bring no baggage with me as chairman of this subcommittee and as sponsor of this particular piece of legislation. I think we all agree that something needs to happen with this fund, and I'm sure we're all going to be constructive in our suggestions of how we get to the goal which all of us share.

Since assuming the chair of the Subcommittee on Housing and Memorial Affairs, I have met with many of you who will be testifying today to discuss the Home Loan Guaranty Program and ways to keep it viable. I told you that I would introduce mortgage indemnity legislation, would await the results of the Peat Marwick study, and would carefully consider any new recommendations to put the program on a sounder financial footing and still keep the entitlement nature of the program intact.

Under current law, veterans must pay a 1 percent user fee in order to get a loan. Under H.R. 1415, veterans would pay an additional ¼-percent fee. In addition, the Federal Government would supplement this fee by ¾ of a percent over a 3-year period. The veteran would be relieved of liability in the event of foreclosure. The Congressional Budget Office estimates that this will generate savings over the existing program.

Service-connected disabled veterans rated 30 percent or more would be exempt from paying the fee, and veterans with downpayments of 5 percent or more would pay a ¾-percent fee, the same as

the Federal Government contribution. I wish to emphasize that this is basically a funding initiative. The guaranty agreement would still be in effect to lenders so that the basic operation of the program remains intact.

The bill would authorize the sale of its loan portfolio, with or without recourse, as long as 90 percent or more was received at time of sale. Several of the VA's nonrecourse loan sales resulted in their receiving approximately 56 cents on the dollar at time of sale. At a time when this program is experiencing severe financial difficulty, this type of sale makes no sense at all.

The bill would also modify the existing refinancing loan provisions to allow for easier refinancing of conventional loans and would reemphasize the equity and good conscience debt waiver provisions of title 38. This provision is designed to refocus the VA's attention on the current law's beneficial and equitable intent.

When some of our witnesses testified on the Loan Guaranty Program earlier this year, they urged that we await the final results of the Peat Markwick study before scheduling hearings. I honored this request. There is no doubt, however, that the results of the Peat Marwick study are very disappointing. There are recommendations for increased user fees up to 4.5 percent, interest rate surcharges, and cafeteria options which are also designed to cost the veteran money. Frankly, I can't see that there is anything in this study, which cost $250,000, that is of much value. The majority of these recommendations negate the current beneficial aspects of the program and, if adopted, would make this program less attractive than FHA or conventional loans.

The Peat Marwick study also analyzed the mortgage indemnity legislation which we will consider today. Their prognosis on this legislation was somewhat gloomy, but that is not surprising since they project an 11 foreclosure rate. This is substantially higher than ever experienced in VA's history, including the problems in Houston and other places associated with the oil industry. Moreover, tighter underwriting and an upswing in the economy should decrease the foreclosure rate, not increase it.

[The prepared statement of Mr. Staggers appears on p. 45.]

Mr STAGGERS. I am pleased that most of our witnesses have substantially softened their position on this legislation. I believe they understand the constraints under which we are operating and realize that our main intent is to keep this a good, workable program.

Before I call our first witness, I would like to recognize the fact that Dan Burton, the ranking member, cannot be with us today. But he does have an opening statement which, without objection, will be made part of the record.

[The statement of Hon. Dan Burton appears at p. 50.]

Mr. STAGGERS. This is a very busy day, as most of you all know, so our first witness I don't believe is with us, Marcy Kaptur, the former chairman of the subcommittee. So we will start with panel 2, the Department of Veterans Affairs, Mr. Vogel, accompanied by Keith Pedigo, Director of Loan Guaranty Services. Also we have Mr. Gasper, accompanied by Mr. Wilson and Miss Neideffer.

As with all the panels, your statements, without objection, will be made part of the record. You can summarize your statements. Also, there may be questions that members of the subcommittee

would like to address to you in writing at a later date, so be prepared to answer those questions at a later date.

Mr. Vogel, we look forward to your testimony.

**STATEMENTS OF R.J. VOGEL, JR., CHIEF BENEFITS DIRECTOR, DEPARTMENT OF VETERANS AFFAIRS; ACCOMPANIED BY KEITH PEDIGO, DIRECTOR, LOAN GUARANTY SERVICE, DVA; AND LOUIS C. GASPER, EXECUTIVE VICE PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION; ACCOMPANIED BY GUY WILSON, VICE PRESIDENT, OFFICE OF MORTGAGE-BACKED SECURITIES, GNMA, AND KIMBERLY NEIDEFFER, ASSISTANT TO THE PRESIDENT**

**STATEMENT OF R.J. VOGEL, JR.**

Mr. VOGEL. Thank you, Mr. Chairman. It is a pleasure to appear before the subcommittee and present the views of the Department of Veterans Affairs on H.R. 1415.

We share your concern, Mr. Chairman, about the future solvency of the program which provides a most important benefit to veterans.

We recently received from Peat, Marwick and Main an actuarial analysis of the Home Loan Program. As we consider the findings in the report, we will be better able to assess more accurately the funding needs of the program. We would be happy to work with the members of the subcommittee on both H.R. 1415 and the proposals contained in the Peat Marwick study.

We have analyzed the details of the bill and would like to make a few specific comments on several of the provisions. We believe that certain provisions would not improve the operation or solvency of the home loan program. Under section 2(c) of the bill, we're not certain of the intended effect of the bill's reference to section 1814 assumptions. Since under H.R. 1415 the veteran would have no underlying liability to the Government, there would appear to be no such liability for the transferee to assume.

We recognize that many times a foreclosure is due to circumstances beyond the ability or capacity of a veteran to handle the obligation. In those cases, we have authority to waive debts. We believe that authority should be used in appropriate cases. We don't think it would be appropriate to have a release of liability in the case of fraud, material fault, or misrepresentation, or when there's a reasonable likelihood that the debt could be repaid.

We propose as an alternative to section 3 of the bill that the subcommittee consider a proposal we recently transmitted to the Speaker of the House. That proposal would provide the Secretary flexibility to sell loans either with or without recourse. By requiring loans to be sold for immediate cash proceeds of at least 90 percent of par, H.R. 1415 would essentially prohibit us from selling loans without recourse. Selling with recourse creates a contingent liability to the Government, runs counter to effective debt management, and does not provide an accurate measurement of the subsidy inherent in Federal credit. As the results from sales already held by VA demonstrate, selling without recourse is a minimally viable option.

Concerning the new permanent budget authority created in H.R. 1415 by requiring a Government matching contribution to the new fund, we believe this concept should be considered in the larger scope of the administration's credit reform proposal which would provide appropriations for subsidy amounts without limiting VA's ability to guarantee loans.

The provision in the bill for revising the computation of available entitlement after prior use of the loan guaranty benefit warrants a comment. We understand that the change is intended to assist veterans who do not currently have a VA loan to obtain interest rate reduction refinancing loans. We would have no objection if it was so limited.

The last provision I would like to comment on is contained in section 5, which changes the criteria for waiver of indebtedness. We don't believe that misrepresentation, material fault, or lack of good faith should be eliminated as bars to waiver. The role that the debtor played in the creation of the debt must be fully considered before waiver can be granted. We believe that material fault, misrepresentation, or lack of good faith on the debtor's part are valid considerations, even absent a clearly provable willful intent to defraud. Therefore, we oppose changing current law to liberalize waivers.

Our concern for the future solvency of the Loan Guaranty Program prompted us to enter into a contract with Peat Marwick, about which you referred a few moments ago. They constructed an econometric model to estimate the costs and actuarial implications of various income and cost features.

We also asked them to take a look at the Veterans' Home Loan Mortgage Indemnity Act. Their analysis indicates that the bill would incur a $160 million shortfall in the fourth year, by fiscal year 1993, and in the fifth year the insurance fund would begin showing a deficit which would continue indefinitely. According to that study, a substantial reserve from which to make investments never accumulates. Therefore, investment income cannot contribute toward long-term solvency.

We estimate that under the proposed law the Loan Guaranty Revolving Fund would require about $3 billion in appropriations through 1994. The loss of new funding fee income contributes to shortfall in the Loan Guaranty Revolving Fund.

The hypothetical veterans' mortgage insurance program analyzed by Peat Marwick had in it the following considerations or characteristics: a zero downpayment, assumability with VA approval, financed fees, default assistance offered by VA, and income from sale of REO.

Potential new funding could come from an increased up-front funding fee, from a sliding scale interest rate surcharge keyed to downpayment, investment income from available funds, and then a "cafeteria" plan, wherein the veteran could choose to purchase any or all of the following: additional entitlement, liability insurance, free assumability, and no-bid insurance for lenders.

We are now in the process of making a detailed analysis of their findings. After we have completed that, we should be in a position to more accurately assess the program's future and what changes are necessary to address those needs.

We share, Mr. Chairman, your concerns about the Loan Guaranty Program and appreciate the willingness of the subcommittee to address those concerns through H.R. 1415. While there are provisions we don't support, there are provisions that are supportable and we would be pleased to work with you and members of the committee and the staff to find the best way to work out some shared risk between the VA and the veteran so as to provide for a better financial picture for the Loan Guaranty Program.

I would be pleased to answer any questions you may have, Mr. Chairman. I thank you.

[The prepared statement of Mr. Vogel appears at p. 56.]

Mr. STAGGERS. Thank you, Mr. Vogel.

Our distinguished colleague, Miss Kaptur, is here, if we could interrupt the panel and let her testify. As I said, I know she is extremely busy and she really is the reason we're here. She is the driving force behind this legislation and she worked so hard on it last year. Marcy, if you would come down to the table.

As chairman of the subcommittee, Marcy was entitled to keep the subcommittee but chose instead to work for the veterans and other very important concerns on the Budget Committee. Although she has considerably smaller feet than I have, I find it a very difficult job to fill her legislative shoes.

Marcy, it's a pleasure to have you here.

## STATEMENT OF HON. MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Miss. KAPTUR. Mr. Chairman, thank you. It's such a pleasure to appear before you this morning and I appreciate the opportunity very much. I want to thank you for your leadership on this matter and for moving this very important bill. I also want to thank the staff on both sides for their continuing efforts to improve this program.

Unfortunately, last year, after we passed this proposal in the House, the Senate didn't take it up. I have a firm belief that all major initiatives seem to start over on this side. So this one follows in that tradition.

Mr. Chairman, it is to your credit that you are taking such fast action this year to ensure this program's long-term restructuring and ultimate survival and stability. Since World War II, we know that over 13 million Americans have been given the dream of home ownership through this program. I still think most people don't realize the important role that it has played in building America from coast to coast. The legislation as proposed, with your strengthening amendments, will really improve the financial condition of the program overall, but I think as important, it will strengthen the position of the veteran borrower and home owner.

The new indemnification fee, along with the Government contributions and the investment provisions, will achieve savings to the Government in the hundreds of millions of dollars. I know that as I go into the Budget Committee meeting this afternoon, this program is going to make it possible for home ownership to be realized by millions of more veterans' families, but also I think we will see some offsetting receipts that will help us on the medical care side

and other areas of the budget where we need to help veterans and are having difficulty in transferring funds from other programs.

Last year the Congressional Budget Office estimated that this bill would save the Federal Government $118 million in 1991, $410 million in 1992, and $638 million in 1993. So that's well over a billion dollars.

Because this proposal incorporates financial restructuring of the program, the reforms provide an ongoing source of revenue to keep the program serving veterans for many years to come. We know full well that if we only kept the existing program on the books, we wouldn't be able to offer a very marketable program to veteran home buyers. I think by eliminating the 1 percent funding fee and replacing it with the new 1¼ percent risk against loss premium, this will, in effect, give veterans peace of mind that, in the tragic event their loans do go into foreclosure, they will not be pursued by the VA for the guaranty amount.

I think we should applaud the efforts of all veterans' organizations who worked so hard with us. In fact, we joked a little bit last year when we were working on this that they never thought they would have to spend this much time on housing legislation for veterans because most of them had been fighting to keep the hospitals open and decent health care providers, and all of a sudden they had to become experts in the mortgage market. So it was kind of a new wrinkle.

I want to point out for the record, since I serve on the other housing committee over on the Banking Committee, that the FHA has a similarly structured program and it rarely pursues individuals whose homes have been foreclosed. Most mortgage bankers really don't bother with deficiency judgments against home owners whose conventional mortgages are under foreclosure. We support you in your efforts to make sure that veterans not be treated more harshly than other home buyers. So we consider this particular proposal one that provides real equity and fair treatment for veterans, because losing one's home and credit rating is devastating enough and provides sufficient incentive to most home owners to avoid default.

I am particularly pleased to see the downpayment savings incentives for veterans that you have included in your measure. At a time when the savings rate in this country is at a shameful level compared to many of our global economic competitors, it is imperative to encourage Americans to save and invest their money in America wherever possible, particularly in home ownership where they can develop real equity.

I want to thank you for giving me an opportunity just to put in my two cents on this program. I also would like to just take 30 seconds to inform you of a matter concerning the Department of Veterans Affairs and a provision to help homeless veterans that was contained in the Veterans Housing, Rehabilitation and Program Improvement Act of 1987, because we have been following that very closely. We know that about a third of homeless people in America are veterans, and we have been following VA's efforts to try to reach out to these individuals. In this bill, we included a provision which offered VA foreclosed properties at a discount to nonprofit organizations and local governments, which were then sup-

posed to renovate the properties to provide shelter to homeless veterans.

It has come to my attention that the VA is not fully promoting this tool to help homeless veterans and, in fact, many loan guarantee officers in regional VA offices seem to be unaware of the program at all. Since this particular provision expires in 1990, I am concerned that the VA's lack of attention to and support of this homeless veterans' assistance program will provide a self-fulfilling prophecy of ineffectiveness when it is evaluated next year. So my hope would be that if this subcommittee does hold oversight hearings on Public Law 100–198, I would hope that you might inquire into this matter and urge the Department of Veterans Affairs to implement fully all aspects of that law.

Again, I want to thank you so very much for allowing me to come here this morning to congratulate you on your leadership, and I offer my full support as we move this to the floor.

[The prepared statement of Hon. Marcy Kaptur appears at p. 67.]

Mr. STAGGERS. Marcy, I would like to say that a person of your ability too often is tapped for everything; everybody wants you. I know that they wanted you on the budget and that's the reason you had to leave us. It amazes me that you have the time and still continue to push for things. You have never forgotten us and we appreciate you being with us today. You are really a driving force behind this legislation and we thank you for your leadership.

I know how strong you feel about this, because I can remember our conversation early last year when you were talking to Congressman Wise from West Virginia and myself, trying to explain to us how much you had gotten involved. I really appreciate your leadership. I think not only the committee and the Congress, but the veterans, owe you a very big thanks. I working with you, I'm sure we'll come up with some solution.

Miss. KAPTUR. Thank you so very much.

Mr. STAGGERS. Any other questions from my colleagues? Mr. Payne.

Mr. PAYNE. Yes. I might just ask one question, if I might.

First, Marcy, thank you for being here. I know how busy you are and I very much appreciate your help. It helps us, the new Members, to have a better understanding, and for someone who has been involved as you have to come and testify before us.

You mentioned the FHA and the structure of that program. Do you know if the indemnity that the FHA offers is the same as what's being proposed by H.R. 1415?

Miss. KAPTUR. It's a similar proposal. Believe it or not, the Veterans Home Loan Guaranty Program never had insurance. It always had a guarantee. This particular proposal makes it more like an insurance program. I think this is very important to the veterans because it provides them equal footing in the market. That's exactly what this bill does. It really modernizes the program, so that it's beyond a guarantee. Rather than just having that 1 percent funding fee, it really uses that to create an insurance program, but we call it an indemnification fee to separate it from the FHA experience.

It is a smaller program, relatively speaking, but not all that much smaller, when you look at the history since the late 1940's.

Mr. PAYNE. So it may not be identical but it is very similar to what is being offered with an FHA loan?

Miss. KAPTUR. Correct.

Mr. PAYNE. Thank you.

Mr. STAGGERS. If there are no further questions, we thank you again for your testimony.

Miss. KAPTUR. I thank Mr. Payne and Mr. Parker for serving on this subcommittee. It's a wonderful subcommittee.

Mr. STAGGERS. Thank you, Marcy.

Now, if we can continue with our second panel, I can promise you we won't "yo-yo" you back and forth and we will finish the panel.

I believe Mr. Vogel had completed his testimony. I understand that the next speaker will be Mr. Gasper.

## STATEMENT OF LOUIS C. GASPER

Mr. GASPER. Thank you, Mr. Chairman, members of the subcommittee.

I have been executive vice president of the Government National Mortgage Association, Ginnie Mae, since February of 1985. I appreciate the opportunity to appear here today in front of you and give some of our views on this legislation, H.R. 1415, which concerns the future of the VA Home Loan Guaranty Program.

Mr. Chairman, as my full statement was submitted in writing in advance, I will be brief in my oral comments. Ginnie Mae generally concurs with the VA's position on this bill, so I'm going to limit myself, if I may, to some special comments and just a couple of notable differences, so that we can leave more time for questions.

Mr. Chairman, on the subject of the indemnity fee, Ginnie Mae is really not in a position to make any recommendation as to the size of that fee. We do, however, support the provision for a lower fee for those veterans who make a minimum downpayment of at least 5 percent on their loans.

As near as we can tell, in our analysis of the bill, Mr. Chairman, we do not see that there is a specific authority for the proposed Government contribution of one-quarter of 1 percent each year for a period of 3 years. We have some concern about how that amount of contribution will be determined and whether it would be enough, combined with the fee income, to be able to cover future losses of the loan program.

On the present revolving fund, we think there should be some concern about that. Provisions for the 1-percent fee expire on September 30 of this year, after which time substantial appropriations would be required to meet the fund's continuing obligations. Out of concern for the solvency of the Loan Guaranty Program, Ginnie Mae urges the subcommittee to address the current obligations of the revolving fund as well as the future obligations under the proposed indemnity fund.

Mr. Chairman, Ginnie Mae cannot support the release from liability provision of the proposed legislation. As we have stated previously before the subcommittee, we think this practice is a sharp and uncalled for departure from conventional loan liability practice. Ginnie Mae believes it is essential that the veteran share the

risk, as well as the gain, that is taken by the lender and the Government in guaranteeing a home loan obligation.

Mr. Chairman, those are my principal points. Before closing, I would like to emphasize the strong commitment of both Secretary Kemp and Ginnie Mae to the administration's goals of home ownership and affordable housing. In order to support those goals, we have to maintain the soundness of all Government housing programs so that we don't put an unwarranted burden on the taxpayer. We look forward to working with the subcommittee and with our friends at the VA in exploring all the possible options available to the VA Home Loan Guaranty Program.

Mr. Chairman, that concludes my oral remarks. I will be glad to answer any questions you may have.

[The prepared statement of Mr. Gasper appears at p. 69.]

Mr. STAGGERS. Thank you.

I guess the disincentive to the veteran about paying the loan is on a lot of people's minds. Can you tell me how much is currently being collected on such defaults if we exclude offsets from service-connected compensation?

Mr. VOGEL. I can provide the figure for the record, Mr. Chairman.

(Subsequently, the Department of Veterans Affairs submitted the following information:)

In fiscal year 1988, a total of $38.7 million out of the total Loan Guaranty debt of $1.753 billion was collected on Loan Guaranty debts through CARS (Centralized Accounts Receivable System). Approximately $17.6 million of that was collected in cash and not through offsets from service-connected compensation.

Mr. VOGEL. I can tell you it's very, very small, the collections are. The amount of debt that typically accrues in a loan guaranty case is sufficiently large that even a good faith effort, when the former home owner is back on his feet, is usually unsuccessful. They're virtually wiped out right after the debt is established and usually remain in that economic circumstance for a period of time.

Ultimately, we do attempt to collect, but the size of those debts, which can easily run $12,000 to $15,000 to $18,000, can cause them to be virtually undischargeable by a lot of individuals. It drives them into bankruptcy and such things as that. A good faith effort, as an example, on a $12,000 or $15,000 debt, to pay $100 a month toward the repayment would cause the veteran who lives out to a typical life expectancy not to personally be able to discharge the principal.

Mr. STAGGERS. But even with the changed law, the service-connected compensation of those veterans will be collected against, also.

Mr. VOGEL. We make offsets from whatever VA benefits would otherwise be payable. You're correct, sir.

Mr. STAGGERS. Mr. Gasper, don't you agree that an entitlement program like the loan guaranty to the veterans, that the veteran is entitled to get something for his up-front payment? I mean, shouldn't a veteran in this type of entitlement get something when he pays a fee?

Mr. GASPER. Mr. Chairman, I think the veteran is getting something. He's getting access to a home loan, and through the Ginnie Mae program, he is getting a good rate on that home loan.

Mr. STAGGERS. But another program where they have an up-front fee, they would get considerably more than from what he's getting out of the VA program, which is supposed to be targeted towards a specific group that we hold and elevate in our society.

Mr. GASPER. In the FHA program, there is likewise an up-front mortgage insurance premium that entitles a person to the insurance of the FHA and, through that, to the Ginnie Mae obligation that is made to the securities market for the funding. I think they're exactly similar. From Ginnie Mae's standpoint, they are very, very similar and that's no problem at all. The FHA program, because of its loan limits, which do not exist in the VA program, is sort of at least targeted towards low and middle income home owners. Fine. It also turns out in that way to be targeted towards the first time home buyer.

I have no problem at all with the fact that the VA program is targeted to another deserving group, one that our country owes its support to, and that is the veterans, whom we did not, in general, pay enough when they were serving. So this is a way in which we, in fact, compensate them. I think that's entirely appropriate.

Mr. STAGGERS. How does Ginnie Mae share in the financial risk of its lenders when a home lender defaults?

Mr. GASPER. The way the Ginnie Mae guaranty program is structured, the lender actually is the issuer of securities which fund those veterans' loans. If the veteran defaults, does not pay on the loan, the lender is nonetheless required to make the required payments to the security holder.

Now, if the lender does not make those payments, then Ginnie Mae must step in with its full faith and credit guarantee of the Government and must pay those security holders. We, therefore, take the loss. If the borrower defaults and then the lender defaults, then it is Ginnie Mae, a Government agency, that covers that loss.

Mr. STAGGERS. Let me switch to the first part of the panel. Let me go to Mr. Pedigo, if I can.

You know, the Peat Marwick study projects a 11-percent rate of foreclosure. This is substantially higher than what you're experiencing today, even in places like Houston, which I mentioned in my opening statement. In view of tighter underwriting and a stabilization in the economy, do you really believe this will be the actual foreclosure rate?

Mr. PEDIGO. My personal opinion is that the actual foreclosure rate will be somewhat less than 11 percent.

Mr. STAGGERS. When you say "somewhat", are you talking 10.5 or substantially less than 11?

Mr. PEDIGO. Estimating the foreclosure rate is, of course, a very difficult thing to do. That's why Peat Marwick, in their preliminary report——

Mr. STAGGERS. Personally, how do you view it?

Mr. PEDIGO. I think that something in the range of 7 to 8 percent is probably more realistic than 11 percent.

Mr. STAGGERS. My time is up. I will have some further questions.

Mr. Parker.

Mr. PARKER. Thank you, Mr. Chairman.

First of all, I join Chairman Montgomery in support this legislation, which will ensure that our veterans and their survivors can have a decent and affordable home.

I want to set something up and ask a couple of questions, if I may. One of the principal functions of the Department is the continued administration of the VA Home Mortgage Loan Program. This program was established as a way of ensuring that veterans and their dependents would have decent and affordable housing. This is not a commercial home loan program, and it should not be administered under the same guidelines.

Certain provisions of the VA regulation, such as 4315(b), recognize this fact and were written in order to guarantee that veterans would not face situations in which partial payments were refused and late charges accumulated leading to foreclosure.

The section states, "A partial payment is a remittance on a loan in default", and it further states that, "The mortgage holder shall accept any partial payment and either apply it to the mortgagor's account or identify it with the mortgagor's account and hold it in a special account pending disposition. When partial payments held for disposition aggregate a fully monthly installment, including escrow, they shall be applied to the mortgagor's account." Now, I'll come back to this requirement in just a second.

One of the major complaints I have heard from veterans in my district about the administration of the loan program is the practice of some mortgage companies of refusing partial payments and then imposing so-called "late charges" on veterans, their widows and orphans, when a payment is late. When a number of these late charges accumulate, it becomes difficult for the veteran or his family to catch up or to pay back what the mortgage company says is due. This is true even when the mortgage payments are brought up-to-date. This practice contributes greatly to a high rate of foreclosure of veterans' home loan mortgages.

The authority of mortgage companies to return these payments is derived from two subsections of the VA regulation that I quoted earlier, which allows the payment to be refused if, one, the payment is less than one full monthly installment, unless the lesser amount has been agreed to under a written payment plan, or the payment is less than 50 percent of the total amount then due, unless the payment amount has been agreed to under a written repayment plan.

Now, my question is this: Doesn't this requirement of a written agreement for a repayment plan effectively deny the veteran the protections provided for in this regulation?

Mr. PEDIGO. It's been some time since I've read that regulation. I thank you for refreshing my memory in such detail.

Mr. PARKER. You're welcome.

Mr. PEDIGO. The regulation that you referred to was drafted by the VA not too many years ago, because there were really no guidelines to address the situation where a veteran has some money to pay for a portion of his delinquency but the lender refuses to accept any.

We feel that the regulation, as drafted, is adequate to protect the veteran in most instances. I think the problem may come about in some offices when the personnel are unable to closely monitor a

particular case and see to it that the lender follows those regulations to a "T". If we were to come up with regulations that were more stringent than that, then I think we would get considerable resistance from the lending community. This is probably the most liberal set of repayment regulations that you will find in any Government loan program, and I can say without question, much more liberal than what a conventional borrower would get in the marketplace.

Mr. PARKER. But does the veteran himself have any means to force a mortgage company to agree to a reasonable payment plan, or for any payment plan for that matter?

Mr. PEDIGO. I would say that in most instances the veteran could not force them to unless he or she were able to get a court to impose some kind of a plan on the lender. But, if the veteran contacts the VA, the VA would be more than willing to work on his or her behalf with the lender in an attempt to work out some appropriate repayment agreement. In fact, we do this daily in the program.

Mr. PARKER. But the veteran himself is basically powerless, as far as in the original agreement, whenever he's going into the agreement?

Mr. PEDIGO. Well, I wouldn't say that he's powerless. As I said, the regulation is in place primarily to protect the veteran. One of the principal responsibilities of a loan service representative of the VA office is to work on the veteran's behalf and try to get the lender to accept a reasonable repayment plan.

Mr. PARKER. What about these late payment charges that keep accumulating?

Mr. PEDIGO. Well, late payment charges are written into most of the mortgage instruments. It is typical for VA, FHA, and conventional loans, to have some type of a late charge provision.

Mr. PARKER. But what about a situation where you've got a veteran who is able to get it paid back, as far as the note payment itself, but the late charges have accumulated and are still there and he can't get rid of them?

You know, I look at it a little differently perhaps. I think a lot of people do. Late charges for a lot of these veterans were paid either in Europe or they were paid in the islands of the South Pacific or in Vietnam or Korea. I mean, this is not a conventional home mortgage plan. You understand where I'm coming from?

Mr. PEDIGO. I understand.

I think there are instances when, if the veteran can pay the delinquent payments but cannot handle the late charges, we would intercede or attempt to intercede on his behalf with the lender and get them to waive those late charges. To my knowledge, we don't have any legal basis for forcing them to waive the late charges, but in appropriate cases, we would certainly work with the veteran and the lender to try to get those late charges waived if the veteran was otherwise able to bring that loan current.

Mr. PARKER. These lenders are not people that are just coming up—you know, it's not as though they don't have a vested interest. They're making money out of this thing. It's not a situation where they're doing us such a great favor. They are making money out of this, you understand.

Mr. GASPER. May I address the point?

Mr. PARKER. Sure.

Mr. GASPER. I have to point out also that virtually 100 percent of the VA loans are securitized through the Ginnie Mae program. Accordingly, that lender has to continue, as I said before, paying the security holder. It doesn't matter what the veteran is doing. We hold them to that. They must pay the security holder. They have to get that money somewhere themselves, too. They have to borrow the working capital or raise the working capital in some way in order to carry those obligations that the veteran is unable, for one reason or another, to fully discharge.

Now, this is not to say that in any particular case the late charges are or are not reasonable, that there shouldn't be some kind of accommodation. But certainly late charges, as far as I can see, are perfectly reasonable commercial practice.

No, these are not conventional loans, you're absolutely right, and they're going to a group that deserves our support, no question about it. But the people who are making the loans are facing a money market that has to be paid. If you keep on loading that, if you load that on to the lender, you're making this program less attractive to the lender. That has got to be a marketing problem ultimately, too.

Mr. PARKER. Okay. What about this agreement, as far as taking partial payments? Is there any way the Department can work out this agreement so that every veteran has an agreement that they can make partial payments? It works both ways, because with computer capability as we have it now, they can make partial payment and cut down on the length of the loan. It goes two ways. In the private sector, it's done all the time, where you make a half payment the first 15 days and you make a half payment the second 15 days, or any part thereof. Why can't we do that?

Mr. PEDIGO. We can do that. In fact, we do it on a daily basis. That is one of the benefits that the veteran gets from our own supplemental servicing. The lender is primarily responsible for servicing a delinquent loan, but we require them to notify us when the veteran is about three months delinquent. At that point, we contact the veteran and assess his or her financial situation.

If we determine that the veteran has some cash assets that could be applied toward the delinquency, we then work with the veteran and the lender to try to arrange some type of a repayment plan. So this is, in fact, done. I'm not saying there aren't cases that occasionally slip through the cracks, but it is our practice to try to help the veteran arrange repayment plans with lenders.

Mr. PARKER. Don't get the idea that I'm trying to take the responsibility of paying back the loans off of the veteran, because that is his responsibility. What I'm looking at is fairness as far as everyone going into the program, having exactly the same type of access to this type of agreement where they can make a partial payment.

My feeling is that if you go in and there are certain circumstances where an individual cannot pay, that's one thing; but it's another thing whenever they refuse to pay. You do have people that will just refuse to pay. They should not be able to retain the housing that they've got if they refuse to pay.

The point that I'm trying to make is, should there not be a program in the Department set up whereby every veteran that comes through and gets a loan will have the opportunity to make a partial payment, because some veterans are not allowed to do that in certain circumstances. That was the point.

Mr. PEDIGO. I guess my response would be that lenders, when they agree to make a loan and accept a guarantee from the VA, agree to abide by all of our regulations. So, in fact, there is such a plan in place. It's a plan that we——

Mr. PARKER. But is it enforced?

Mr. PEDIGO. We enforce it when we are aware that it has not been properly complied with.

Mr. PARKER. I personally think that every veteran who gets a loan should know that they have that right.

Let me ask you this. Do you know how many foreclosures are caused by the mortgage companies invoking this regulation of not receiving—of late charges and so forth? Do you have that broken down?

Mr. PEDIGO. No, we do not.

Mr. PARKER. I think that would be some interesting information, if you could break it out, just to see what impact these late charges and the accumulation have, and also the impact of not being able to make partial payments. I think there is some impact out there.

Could I ask one more question?

Mr. STAGGERS. Without objection, the gentleman is allowed an additional 5 minutes.

Mr. PARKER. The economic conditions in the oil belt areas have obviously caused many of the foreclosures. I made a trip down to Houston not long ago and it's very obvious. What is the latest trend in these areas as far as the oil belt area is concerned?

Mr. VOGEL. Mr. Parker, in Texas and Louisiana, we see at least a bottoming out and a turning around, although it's marginal at best. We are still seeing a lot of defaults and the resulting foreclosures in Colorado and a few of the energy-dependent States.

We have endeavored, especially in the Houston market, in the jurisdictional area that that office takes in, to put additional human resources into servicing loans. It has worked and worked well. We have had a better cure rate. We have had fewer claims paid. That can only be done by good, aggressive servicing and then ultimately, the bottom line is the veteran has to have the resources to pay the loan.

We think it has bottomed out and is turning around. The number of defaults pending now when compared to last year has dropped 4.9 percent.

Mr. PARKER. I hope you're right, I really do.

Outside of an unusually high foreclosure forecast, we can find nothing new in the Peat Marwick study. What in that report do you consider was worth $250,000?

Mr. PEDIGO. The reason that we asked Peat Marwick to do the study was so that they could provide us with numerous alternatives to restructuring the VA program. That, in fact, is what they did for us. They presented us with a menu of alternatives and the cost factors that would be associated with those alternatives, so that we feel we are now in a position to assess that report and

decide if we think the program should be restructured and, if so, how it should be restructured. In doing so, we would have cost figures to go with it, so that we would know what that restructured program would cost the taxpayers as well as the veteran. We think there was considerable benefit from that study, even though there are some aspects of the study that we do not agree with.

Mr. GASPER. Mr. Parker, if I could also respond, at least in part, I think we've just gotten a copy of the Peat Marwick study so we're in the depths of analyzing the thing and will try to have some kind of additional comment ourselves. We will be talking with the VA about that study.

I would urge you, however, not necessarily to dismiss out of hand what appears to be an unusually large default rate. One of the problems that Ginnie Mae is running into in the billions of dollars of servicing we've had to take over down in the "colt" States, as we call them, is that there are a lot of foreclosures that are masquerading, in fact, as delinquencies. The VA program presently has a perverse incentive in it for the lender to stack his no-bids, as we call them, against the wall.

It has very often happened, when we go into a portfolio, we find out that a lot of what are being carried as delinquencies are really foreclosures—they may even be empty units that nobody has paid on for a long time. But it was impossible for the lender to move to foreclosure because the average loss on each of those no-bid cases is around $20,000. It was better to continue paying the security holder who may, in fact, be lending his money at a lot less than prime, it was better to do that than to have to go out and borrow the bank money in order to pay off the situation in the event of a no-bid. So they will stack the things against the corner there, and when we come in, we found out our foreclosure rate is not just 3 percent; it's 25 percent in these portfolios.

So as I say, we are still analyzing this. But I'm not willing to dismiss out of hand the projection of a much higher foreclosure rate than we seem to have seen in the past. I think a lot of it has been hidden.

Mr. PARKER. How many of these companies are out there? I mean, have you checked all of them?

Mr. GASPER. No, we haven't. I haven't checked all of them. Still, my first priority is to find out how many among these institutions are being taken over by FSLIC and FDIC, to find out how many of those have got somewhere or another a Ginnie Mae portfolio inside them.

But about one-third of our total surety is on VA loans. That would amount to something well in excess of $100 billion. Regrettably, there is, frankly, a lot of it concentrated in some States. We have a lot of business down in Oklahoma and Texas. GNMA took over one single portfolio that had $2.4 billion. I believe, all together, we're going to lose over $100 million for sure on that portfolio. We paid $30 million the first day. I had to fill up the escrows.

That is a serious problem. Again, I just urge you to, indeed, take a careful look at that foreclosure rate and a careful look, in fact, about how this present program is playing out for us. You're running through the lenders' capital, and when you're through with

that, you're going to run through Ginnie Mae's capital. It's still the Government that's going to be taking that loss.

Mr. PARKER. It's special, I'll tell you. Thank you very much. I appreciate it.

Mr. GASPER. Thank you, sir.

Mr. PARKER. Thank you, Mr. Chairman.

Mr. JONES (presiding). Gentlemen, thank you. I'm Congressman Jones from Georgia. As you know, Chairman Staggers had to leave. I would like to ask a few questions, if I may.

Mr. Vogel, you object to the indemnity provision contained in the bill. Why shouldn't a veteran be permitted to buy indemnity against indebtedness just as he can buy insurance indemnity against any other contingency? Are you arguing principle or price?

Mr. VOGEL. Mr. Jones, I'm probably arguing principle more than anything else in putting that position forward. The view of the administration is that a release of liability could, in fact, provide a disincentive to keeping loans current; that there is not enough funding provided by the proposed bill which would, in fact, provide a full indemnification for governmental loss. We articulated that as best we could in our prepared statement.

Mr. JONES. With regard to waiver, we have a statute designed to grant equitable relief, but in our observation of your application of the current statute, you are far from equitable in many cases.

What language can we enact that will convince you we want decisions based on equity and good conscience and not on the remote possibility that the veteran may become solvent 10 years from now?

Mr. VOGEL. Mr. Chairman, in the comparative recent past, we have reissued instructions to our regional office personnel on dealing with cases before it for consideration of waiver or compromise. It was intended, and we believe it's working, to provide, in fact, a great deal more in waivers in these cases. It will take a little more experience to see what the final outcome is. Early indications are that it's a positive thing and has been recently well received by the regional office personnel and by the veterans' service organizations.

Waiver of payments are, by ruling of the Internal Revenue Service, reportable as income for veterans purposes. Consideration is being given internally to a program which would, in fact, perhaps not establish that amount of debt or any debt at all. Administratively, that issue is under debate in the Department of Veterans Affairs and we may have an answer on that in a comparatively short time frame.

Mr. JONES. Thank you very much.

One other question for Mr. Pedigo. Isn't it true that if you sold your loan assets with recourse, you would receive substantially more money on the day of the sale than selling without recourse?

Mr. PEDIGO. That is true.

Mr. JONES. Well, that's all of the questions, I think, so thank you all very much for your time and for your input. We are all very appreciative of your appearance.

Mr. VOGEL. Thank you, Mr. Chairman.

Mr. GASPER. Thank you.

Mr. JONES. Without objection, Mr. Burton desires to submit questions for the record. Hearing no objection, so ordered.

Mr. JONES. Our next witness is Mr. David Leen, if you would come forward, please. Mr. Leen has traveled a great distance from Seattle, WA at his own expense, and we welcome you here and look forward to your testimony. Thank you for coming.

**STATEMENT OF DAVID A. LEEN, ESQ., ATTORNEY, SEATTLE, WA**

Mr. LEEN. Thank you very much, Mr. Chairman. It is one of the highest honors I've had in my lifetime to be not only a veteran but to have an opportunity to speak to a congressional committee on an issue that I have strong personal feelings about.

I am here on behalf of a number of veterans that do not have a lobbyist. They are the people that Mr. Vogel talked about, that have been wiped out by foreclosures; they have no funds, some of them are on the streets, some of them live in cars, they don't vote, and they don't join clubs and groups like the VFW that can help them out.

It is a tragic situation. I believe an analysis of the current setting is a very useful guide to developing solutions to what is a fairly serious problem.

What I would like to do is really address two issues relating to the waiver of indemnity program. I fully endorse the bill as it's written. I think it's a good and sensible and economical step that minimizes the tremendous amount of hardship. It is unfortunate that the bill probably cannot deal with the numbers of people out there today from whom the VA is seeking to collect a sum that approximates $2 billion. There are approximately 200,000 to 250,000 cases that the VA is actively pursuing. I would like to just discuss, at least in general terms, the current situation as I see it.

The reason I have been acquainted with this issue is because of some litigation with Mr. Vogel's office, in the State of Washington, that has resulted in a court determining that the VA cannot collect deficiencies in the State of Washington because of State law. That issue is being appealed by the VA at this point, but it follows along with the practices by commercial lenders on FHA and HUD housing programs.

No other programs, either commercial or private, besides the Veterans' Administration, to my knowledge, actively pursues deficiencies because they operate with a different philosophy. They're concerned about economics rather than the principle. We saw this difference in the views that Mr. Vogel expressed when he said "it's a matter of principle." I'm not questioning the principle, but I do question the extent that we can continue to use the taxpayers money to subsidize the process.

As I indicated, this huge amount of indebtedness results from foreclosures, many of which are completely beyond the control of the veteran. Although some of the veterans may be fiscally irresponsible, "deadbeats", the lowest form of life, most veterans in my experience really want to keep their house. That's the last thing they want to let go.

I can't believe—and I have never seen any support for the concept—that releasing the liability of the lender will contribute to de-

fault. It is inconceivable to me that this would motivate somebody to let go of the most precious material item that an American can have. It has not been my experience in 18 years of practice representing mainly poor people in the housing area.

Because of the time, I am not able to go into some of my background, but I have spent a number of years working for legal aid programs, and now, regretfully, I have the same clients as a private attorney.

The problem with the collection process that is used now is that the amount of the deficiencies are generally set without any hearing whatsoever for the veteran. In many States, the foreclosure is achieved by a nonjudicial, unsupervised process. At least this is done in the West, perhaps in one-third of all of the States. I'm not an expert nationally on this topic, but I know at least in the State of Washington and many of the western States there is no hearing.

The veteran has a theoretical right to a hearing to question the validity of the debt, but the VA, of course, merely says here's the loan and it's not been paid, the difference is what you owe us. So that is not a meaningful hearing.

The other option that the veteran has is the waiver program. Mr. Vogel and Mr. Pedigo mentioned the VA has the option of waiving this indebtedness. It is my strong conviction that the worst thing that can happen to a destitute veteran who would qualify for a waiver is that it be granted. The VA notifies the IRS that the debt is forgiven which generates tax liability. The tax liability is nondischargeable in bankruptcy and is approximately 25 percent of the total debt. We're talking in many, many cases of $27,500 plus interest liabilities. In order to get a waiver, a person must be destitute presently and the VA has to be convinced that there is no possibility of collection.

I sense that that's my time. I will be glad to answer any questions if there are any.

[The prepared statement of Mr. Leen appears at p. 76.]

Mr. JONES. Thank you very much. On behalf of the many thousands of veterans in the Fourth District of Georgia, who find themselves in similar circumstances as those in Seattle that you represent, I thank you on their behalf, also. I would like to ask you a few questions.

First of all, in your experience—and I know you've had a lot of it—with veterans who have lost their homes in foreclosure, do you believe that any of them would have abandoned their mortgages earlier if they were covered by indemnity, or do you believe significant numbers of additional veterans would walk away from loans if indemnified? I know you touched on that briefly, but I wonder if you would elaborate.

Mr. LEEN. I am convinced that the potential future liability is of little concern to one that is not able to make their next month's house payment. Many consumers are aware that there is bankruptcy. If they're unemployed, disabled, destitute, there is no real concern that anything else can be taken. Their only worry is their house.

Mr. JONES. Do you think the lenders do a good job servicing these loans?

Mr. LEEN. I am embarrassed to say that that is the most egregious aspect of the program. The General Accounting Office, in its remarks last year to this committee, recognized that with a mere 2-percent increase in its staffing in that area, $55 million could be saved. I believe almost 50 percent of the losses could be corrected, and that correction could begin this afternoon with a computer-generated letter by the Veterans' Administration to every lender, saying that we will not pay on a guarantee unless you certify that you have considered every alternative that is available and you tell us why that will not work in this particular case. That letter could go out today. They have the ability to send things out that fast. It would be a simple letter.

I think Mr. Payne's suggestion about a form that would set up part payments would be a very good start for a check list on other alternatives, such as taking late payments and tacking those on to the end of the loan obligation, which is a common practice used in the commercial industry and is allowed by the regulations and used by FHA. So I think that's a tremendously important vehicle to save the taxpayers money and allow the veterans to retain their houses. I really do.

Mr. JONES. I appreciate your comments and I thank you.

We have been rejoined by my distinguished colleague from Virginia, Mr. Payne. Do you have any questions?

Mr. PAYNE. Yes. First of all, Mr. Leen, thank you very much for coming. I know you have come a long way for this, and although a lot of our colleagues aren't here because of other engagements and so forth, this testimony that you have given and what it will say in the record will be extremely important in all of our considerations. So I very much appreciate the fact that you are here and are helping us with this.

Do you think there might be some instances in which the VA ought to pursue and collect in the event of a default, and subsequently, if people move out of their homes?

Mr. LEEN. I agree. I am not for completely throwing taxpayers money away. I would urge the committee to look at the HUD system, its final rule—at least the one that I recently saw, which I can't tell you the volume. But the HUD program basically does not pursue deficiency judgments. They have considered and rejected the VA's indemnity concept. They collect, where feasible, such as when the deficiency falls into a category such as repeat defaulters and nonowner occupant investors.

I think when there's fraud, waste, substantial misrepresentation on the application for a loan, that those are certainly reasonable cases for exceptions to the general rule. I have no problem with that and think that perhaps the Government has a duty to prevent that kind of abuse. Equity skimmers are preying upon veterans, at least until recent corrections to the assumability provisions, because they were freely assumable. Many of my clients have made every payment to the VA, sold their house, sold again to an equity skimmer, and 4 years later they heard there was a foreclosure and they now owe $27,000, after never missing a payment and having perfect credit. I think those kinds of equity skimmers, besides the criminal penalties that I know Congress has addressed, should be pursued with vigor in terms of deficiencies.

Mr. PAYNE. Thank you, Mr. Chairman.

Mr. JONES. Thank you.

Thank you, Mr. Leen. The committee thanks you. We appreciate your coming here. I personally appreciate the work that you've done on behalf of America's veterans.

Mr. LEEN. Thank you very much.

Mr. JONES. I wish you well.

If our next panel could come forward. With us today is Mr. Jerry McGuire, who is chairman of the Government Mortgage Program Committee of the National Association of Realtors; Mr. James A. Abbott, who is chairman of the Legislative Committee of the Mortgage Bankers Association of America; Mr. James Irvine, chairman, Federal Governmental Affairs Committee of the National Association of Home Builders; and Mr. Joe Owens is vice president of finance with the Manufactured Housing Institute.

Gentlemen, we welcome you here. We thank you for joining us today.

I don't know if this is good news or bad news, but we do have a quorum call. I think it is in the best interests of all if you would excuse us for about 15 or 20 minutes. We have to go over the the floor. So we will adjourn until about 12:35. I thank you for your patience and forbearance.

[Whereupon, the subcommittee was in recess.]

Mr. JONES. The subcommittee will be in order.

Thank you once again for coming here today. We appreciate your involvement and your input. Let's start with Mr. McGuire's statement, please.

## STATEMENTS OF JERRY MC GUIRE, CHAIRMAN, GOVERNMENT MORTGAGE PROGRAM COMMITTEE, NATIONAL ASSOCIATION OF REALTORS; JAMES A. ABBOTT, CHAIRMAN, LEGISLATIVE COMMITTEE, MORTGAGE BANKERS ASSOCIATION OF AMERICA; JAMES IRVINE, CHAIRMAN, FEDERAL GOVERNMENT AFFAIRS COMMITTEE, NATIONAL ASSOCIATION OF HOME BUILDERS; AND JOSEPH OWENS, VICE PRESIDENT OF FINANCE, MANUFACTURED HOUSING INSTITUTE

### STATEMENT OF JERRY MC GUIRE

Mr. MCGUIRE. Thank you.

Mr. Chairman and members of the subcommittee, my name is Jerry McGuire and I'm a realtor from Denver, CO. On behalf of the more than 800,000 members of the National Association, I would like to thank you for the opportunity to testify on H.R. 1415.

As you know, last year the Association testified before this subcommittee in opposition to the indemnity bill. We understand and appreciate, however, that you have introduced H.R. 1415 as a framework from which discussion will build. Although the National Association of Realtors has modified its formal policy position somewhat as a result of deliberations amongst our membership, we continue to have certain concerns about the bill.

Specifically, our concerns with the indemnity fund proposal include, number one, the role of indemnity. The National Association of Realtors continues to question the appropriateness of providing blanket indemnity to a veteran upon the purchase of his or her

home. Blanket indemnity, that is, the removal of any and all liability for a mortgage loan, could potentially become a greater risk to the VA Home Loan Guaranty Program because it could increase foreclosures. In addition, there are situations in which it is appropriate to require borrowers to be responsible for deficiencies after foreclosures, specifically such situations as fraud, misrepresentation, or willful default.

The Association cannot condone the concept of complete and blanket indemnity. However, we are aware that there are certain specific cases—that is, loss of job or depression of the local economy—where indemnification may be appropriate. Accordingly, the National Association of Realtors believes indemnity should be allowed by the Department of Veterans Affairs on a case-by-case basis. In essence, we believe our efforts should not be as much directed towards indemnification, which is an after-the-fact event, but towards foreclosure prevention, which keeps the veteran in the home.

Second, the increase of funding fee. The National Association of Realtors opposes the proposed increase of 0.25 in the amount of the up-front fees that a veteran will be required to pay to obtain a VA guarantee mortgage. Further, this legislation would make the fee permanent, and increasing the fee on loans would raise up-front costs for veterans and could represent a tax on veteran home buyers.

We recognize that supporters of this legislation contend the entitlement nature of the program is maintained in that the proposed increase in the up-front fee is more than offset by complete indemnification upon default. While there may be some merit in this argument, it disregards an even more fundamental problem—the initial ability of veterans to pay the proposed 25 basis point increase at all. Given the ever-increasing housing affordability crisis of higher housing prices and interest rates, 25 basis points could mean the difference between a veteran owning or not owning a home. Unilateral protection of the veteran, once he or she has already purchased a home, does not vitiate or otherwise diminish the initial hurdle. Consequently, we cannot support the proposed increase in the up-front funding fee.

On the sale of vendee loans, the proposed bill would authorize the Veterans' Administration to sell vendee loans with or without recourse, provided that the purchase price is at least 90 percent of the unpaid loan balance. The Association is pleased to support the proposed bill's establishment of a meaningful threshold for the sale of Department of Veterans Affairs vendee loans with or without recourse.

Use of funds. We understand that, under the proposal, VA would be authorized to invest portions of its stockpiled funds in order to increase earnings. We are in agreement that any portion of the indemnity fund that is not required to meet current payments should be invested in obligations guaranteed by the United States Government. If this approach is adopted, then the legislation should carefully stipulate that, whether earned or accumulated under the proposed indemnity program, all funds should be used solely to cover the costs and obligation of the VA Mortgage Indemnity Program.

However, we cannot help but be concerned over the recently released Peat Marwick analysis of the mortgage indemnification fund balance. This analysis of Peat Marwick indicated the indemnity fund will diminish to a deficit balance in 1993. Investment income provides little benefit under this program, since the fund balance becomes negative after 4 years. Since the Peat Marwick study has just been made available, we respectfully request that you allow our Association the opportunity to review the results and conclusions of the study prior to issuing any comments regarding the analysis.

Mr. Chairman, we appreciate the opportunity to testify at these hearings on the Veterans Home Loan Mortgage Indemnity Act of 1989. The Association has appointed a task force which will study the Peat Marwick and other proposals which strive to make this an effective program. I will be happy to try to answer any questions you may have.

[The prepared statement of Mr. McGuire appears at p. 85.]

Mr. JONES. Thank you, Mr. McGuire. We appreciate your testimony.

Unless there is objection from my colleague, we will hear testimony from the entire panel and then we will ask questions.

Mr. Abbott, we would like to hear from you now.

## STATEMENT OF JAMES A. ABBOTT

Mr. ABBOTT. Thank you very much, Mr. Chairman, and members of the subcommittee. I am Jim Abbott, president and chief executive officer of First Union Mortgage Corporation in Charlotte, NC. MBA appreciates this opportunity to testify on H.R. 1415 and would like to comment on the change proposed by the VA to the no-bid formula.

Mr. Chairman, MBA understands the interest in exploring a new financing mechanism for the VA Home Loan Program. Currently, the lender, the veteran, and the Federal Government are bearing heavy cost burdens, but the program is still in distress. In 1988, lenders incurred $200 million of losses on no-bids.

MBA believes there is merit to the proposal in the bill to match the funding fee with the downpayment. A sliding scale funding fee preserves the existing no downpayment benefits offered by the VA loan program, yet veterans would bear a burden commensurate with the risk associated with the benefits. However, Congress should consider whether such action alters the entitlement nature of the program.

The bill also proposes to release veterans from liability to the VA in cases of default on their VA loans. Congress should make a conscious decision about the impact of a Government policy where borrowers know that there is impunity in case of defaults on their loans. We urge that liability be decided on a case-by-case basis.

In addition, the proposed release from liability would apply only to properties acquired by the VA. When lenders acquire the properties, they are not indemnified by the VA for all of their losses. They still have the right to collect from veterans the debt that remains unsatisfied. Because of the no-bid formula, the indemnity

proposal only grants the veteran a conditional release from liability—some get it and some don't.

The Peat Marwick report, which was previously mentioned, concludes that the indemnity fund would be solvent in the first 4 years, followed by a deficit balance through years 5 through 35. Some changes to the proposal might result in a reversal of this situation. The rate at which the Federal Government's 75 basis points are contributed might be accelerated, and the sliding scale funding fee based on the amount of the downpayment might be adjusted.

The other key issue on which I would like to comment is the VA's proposed change in the no-bid formula. In its proposed FY 1990 budget, the VA reported it would make a change to the no-bid regulations to include the "cost" of Government borrowing to acquire a foreclosed property among the VA's costs when calculating the property's "net value." The VA notified the VA committees on January 1, as it was required to do, that it intended to implement this change on October 1, 1989. Two months later, the VA published the proposed net value regulation with an effective date of August 1.

This action ignores the report language accompanying the 1984 Deficit Reduction Act which enacted the no-bid formula. The VA has apparently interpreted the notification procedure as nonbinding because it has not complied with it for FY 1989. However, the language of the no-bid statute is binding, and the change made by the VA in the proposed regulation appears to be contrary to the authority given to it by the statute.

The VA's new regulation for net value would change the words "costs . . . incurred by VA" to "costs . . . incurred by the Government." This regulatory change of who is incurring the estimated costs is in direct conflict with the statute, which clearly allows a deduction only for those "amounts which the Secretary estimates the Secretary would incur", not those amounts which the Government would incur. Because the cost of Government borrowing is not a cost incurred by the Secretary, the statute does not permit it to be included in net value.

MBA strongly opposes this change in the no-bid calculation. Lenders will suffer $20 million of additional losses in FY 1989 and believe that irreversible damage will be done to the VA Home Loan Guaranty Program.

Since the no-bid formula was enacted, VA's market share of fixed-rate loan originations has been steadily declining, from 13 percent in 1984 to 7.9 percent in 1988. Lenders are reacting to their increased potential liability when deciding whether or not to participate in the VA program.

In 1988, my company incurred unanticipated losses of $3 million in VA no-bids. We, as a mortgage banker, are not a portfolio lender and do not receive interest income to pay for these losses. Mortgage bankers only receive a small service fee for servicing VA loans for the investor purchasers.

In 1988, our company, First Union Mortgage, had to service 22,000 loans free, or at no profit at all, to offset these losses. In 1987 and 1988, we provided veterans with $1 billion and $800 million, respectively, in home financing. I can assure you that if the change in the no-bid formula is enacted, we will implement further

strategic changes to our loan origination efforts to minimize home lending to veterans who so courageously served our country.

MBA appreciates the opportunity to testify.

[The prepared statement of Mr. Abbott appears at p. 89.]

Mr. JONES. Thank you very much, Mr. Abbott.

We would like to hear now from Mr. Irvine, who is Chairman of the Federal Government Affairs Committee for the National Association of Home Builders.

## STATEMENT OF JAMES IRVINE

Mr. IRVINE. Thank you, Mr. Chairman, members of the committee. I am Jim Irvine. I'm a home builder from Portland, OR, and I am here today to testify on behalf of the 155,000 member companies of the National Association of Home Builders.

I have been a VA builder since 1973, and as the chairman said, I am currently the chairman of NAHB's Federal Government Affairs Committee.

Today you have asked for our views on the Veterans' Home Loan Mortgage Indemnity Act. Before enacting this legislation again this year, we urge you to reassess its effects and impacts on the VA Home Loan Guaranty Program, which was created as an entitlement for veterans who have so ably served in our military forces.

A review of the program must recognize that the nature of an entitlement program is fundamentally different from that of a traditional financing program and requires a higher level of commitment from Congress. We urge that any changes to the operation of the program in the future be carefully made without jeopardizing the entitlement nature of the VA guarantee.

I understand the purpose of this legislation is to ensure the actuarial soundness of the VA loan program. As you look at your proposal, it is important to point out that the economy is turning around in some of the depressed areas that were the cause of high foreclosures and delinquencies in the Home Loan Programover the past few years. Because of this, future appropriations may not need to be as substantial to sustain the loan guaranty revolving fund.

For example, even in Houston, TX, one of the most depressed areas during the recent economic downturn, building permits, an indicator of future housing starts, increased in the Houston area by 24 percent from 1987 to 1988. Houston's unemployment dropped from 6.7 percent to 5.4 percent over the same time frame. This is a very substantial decline considering the deep recession which Houston experienced over the past few years.

Before passing legislation to make permanent changes in the program to solve the revolving fund problem, the fundamental question of why the program was created and the constituency which it serves must be carefully analyzed.

The Mortgage Indemnity Act that passed last year sought to gain solvency in the VA home loan program. NAHB is concerned, however, that this legislation will not achieve its desired objective of making the program actuarially sound.

While the program may have the appearance of working, there are many concerns which must be examined before passing this legislation. A 2 percent indemnification fee, split with 1¼ to the

buyer and ¾ to the Government, may be insufficient to cover the losses in the program on new loans. The fee may have to be higher to make the program actuarilly sound. In all likelihood, some initial capital infusion or an additional appropriation may be necessary as well.

As referred to before, the recently published Peat Marwick study emphasizes that a deficit balance is created under the indemnity bill. As has been noted, it goes to a deficit in 1993 and continues in that deficit until the year 2023. Investment income provides little benefit under this program, since the fund's balance becomes negative after the first 4 years. The increase in funding fee income generated by this program as proposed appears negated by the additional risk of foreclosure associated with the removal of liability from a veteran upon defaulting on a VA loan.

We suggest that the VA be asked to determine what level of Government contribution would be required to make the program work. We urge that it not be an increase in the veteran's contribution.

Additionally, because the Government is making a contribution on the new mortgage indemnity fund on behalf of the veteran, an estimate of this amount would have to be appropriated each year by Congress. We have concerns that this estimate may not be enough to cover the Government's cost and that you will, in effect, put an artificial ceiling on the program, which occurred in FY 1986 under sequestration, thereby eliminating veterans access to the program.

If I may, I would also like to take this opportunity to again comment on an adjustable rate mortgage for VA buyers. A VA ARM is necessary to modernize the VA home loan program. We urge that you include it in your legislative initiatives for this year. The ARM, in other areas of mortgage lending, has been a pivotal contributor to home ownership rates and housing affordability.

In closing, I would like to reiterate that we're concerned that the Mortgage Indemnity Act, while making sweeping changes in the program, may not achieve its stated goals and objectives of making the program actuarially sound. Further, retaining the benefit nature of the program must be considered when making changes in this long-standing entitlement program. The VA program has been a significant cog in the mechanics of the home ownership wheel. At a time when home ownership rates are declining, we discourage you from making any change to the VA Home Loan Programwhich would erode the program's 45-year history of assisting American veterans with home ownership opportunities.

Thank you.

[The prepared statement of Mr. Irvine appears at p. 96.]

Mr. JONES. Thank you, Mr. Irvine. We very much appreciate your testimony, your input, and your expertise.

We would now like to turn to Mr. Joe Owens, who is Vice President of Finance for the Manufactured Housing Institute. Mr. Owens.

## STATEMENT OF JOSEPH OWENS

Mr. OWENS. Thank you, Mr. Chairman. My remarks today are on behalf of the members of the Manufactured Housing Institute, people who build manufactured homes, a product formerly known as mobile homes.

We certainly support the subcommittee's goal of strengthening the VA Home Loan Program because we believe it provides an important benefit to veterans that they deserve to have continued. We are concerned, however, that the creation of a mortgage indemnity fund may not fully accomplish that purpose. The indemnity fund places a large part of the burden of paying for the program squarely on the backs of the veterans. It could drive veterans from the program and, as a practical matter, the imposition of a fee introduces a fundamental change in the nature of the program as a benefit or entitlement program.

Collecting a fee for using the program has the effect on the veteran of changing the benefit program to an insurance program, where most of the premiums are collected at the beginning of the policy. To the extent that the mortgage indemnity fund proposal takes the VA program in the direction of an insurance program, in our opinion it could lead to the abolition of the program by its merger into the Federal Housing Administration loan insurance program currently administered by HUD.

Certainly the VA revolving fund cannot continue to sustain losses, as it has over the last several years, without seriously jeopardizing the entire program. We all know that new money for programs such as this one is not in the cards, at least for the near future, and there is continuing pressure to reduce the Federal budget deficit. Additional authorizations may be necessary over the next several years to pay for additional losses in the absence of some kind of self-funding proposal such as the one proposed. We know those to be the realities, but we question the fairness of the mortgage indemnity fund proposal to the veteran, who has every right to expect the same benefits as those who served before him.

We would respectfully submit that the introduction of a mortgage indemnity fee would work to the detriment of the veteran borrower. While it might turn the program into a pay-as-you-go program, it would undermine the benefit nature of the program. That would be an unfortunate disservice, in our opinion, to the thousands of men and women who have sacrificed so much in the service of their country.

For veterans who purchase a manufactured home with a loan guaranteed by the VA, the benefits of the program have already been reduced. The Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987 imposed a 5 percent downpayment requirement on loans secured by a manufactured home. This is a major departure from the no downpayment feature of the VA Home Loan Program generally. Loans secured by site-built homes still require no downpayment.

It seems incongruous that veterans purchasing more expensive site-built homes may do so with less cash than veterans purchasing more affordable manufactured homes. Veterans who purchase manufactured homes generally are borrowers with low to moderate

incomes who cannot qualify for a loan on a site-built home. The added burden of a 5-percent downpayment makes the purchase of a manufactured home even more difficult and, in many cases, prevents the veteran from using a benefit earned from years of service in the Armed Forces.

Since the implementation of the downpayment requirement on manufactured Home Loan Program in February of 1988, loan volume in the program has slowed to a trickle. Only 1,674 manufactured home loans were guaranteed by the VA in 1988, the lowest annual volume in the program since its inception almost 20 years ago. Monthly volume has declined from an average of 200 to 400 loans per month to less than 100 per month.

We would urge the subcommittee to eliminate the downpayment requirement on VA-guaranteed manufactured home loans, return the program to a parity basis with its site-built housing program, and return the benefit to the veteran that this requirement took away.

Thank you again for the opportunity to testify.

[The statement of Jerry C. Connors, delivered by Joseph Owens, appears at p. 114.]

Mr. JONES. Thank you.

Since we're on the subject, I would like to start the questioning with you, Mr. Owens, because I think you can be a big help in illuminating and edifying my education here.

We know that defaults in manufactured housing are substantially higher than for site-built homes. Now, it seems to me that—and correct me if I'm wrong—that you're in opposition to indemnity and to downpayments. Therefore, what remedy do you recommend to correct the imbalance between the defaults in manufactured housing and site-built homes?

Mr. OWENS. I'm not sure that there is a plan you can implement to correct the imbalance in defaults between basically, I think, two different types of borrowers. In general, site-built borrowers tend to be higher income people, at least on average. You don't have the preponderance of low- to moderate-income people that you have in the manufactured housing area. So I just think as a matter of course, by definition, the manufactured home borrower is going to have a lower income, generally a blue collar worker, subject to economic—probably the first victim of economic downturns. So I think you have to take that as a given, that, in general, manufactured home loan default rates are going to be higher than they will be on site-built homes.

I happen to be a veteran and I own a home financed by a VA-backed mortgage. My income is substantially higher, I would expect, which is partly because I live in the Washington area, but it is also partly because of education, et cetera. I am not a typical manufactured home buyer.

Mr. JONES. Do you live in a manufactured home?

Mr. OWENS. No, I don't. I live in a townhouse. I think you would have to move a long way out of Washington to find a place where you could put a manufactured home. That's another problem we have.

Mr. JONES. Thank you very much. I appreciate that, and I appreciate your testimony.

Mr. Payne, do you have any questions for Mr. Owens?

Mr. PAYNE. I have a question maybe for Mr. McGuire, and this has to do with a subject we spoke about earlier this year, the whole notion of a healthy entitlement on the one hand and actuarial soundness on the other, and where is it that we ought to fall in the spectrum. At the time we were concerned because the President's proposal showed that he felt we ought to be looking at initial points and so forth of about 3.8 percent, as I remember the proposal. We all felt that was not appropriate.

Now we have a proposal that says the veteran, which instead of paying one point—which essentially has been done—that that moves to one and a quarter, or 1.25. And as you point out, those 25 basis points may be important. On a $40,000 loan, that would equate to $100, I think.

Do you feel there is anywhere along that spectrum, over and above the one point that currently is the way it is being administered, where this might move to maintain the entitlement, such that it's better than any kind of conventional financing, but yet, at the same time, to move it toward more actuarial soundness?

Mr. MCGUIRE. Well, Mr. Payne, I think it really boils down—and that's what our association is wrestling with now—on just how much of an entitlement are we going to maintain. I don't know that the 0.25 is anything that's going to even come close. I guess the Peat Marwick study verifies that.

Personally, I don't think the 0.25 would be that big an impact on a veteran, but we have been opposed to increasing the user fees and I think it is something that has to be raised significantly before it has any impact on the fund, I think.

So I don't know for sure if it answers that question. I think it has to go up quite a lot in order to make it actuarially sound.

Mr. PAYNE. I think there are two issues. One is what should the veteran pay, and then, two, how much should be set aside in order to make it actuarially sound. What I hear from the Peat Marwick study is that 2 percent, if they're correct in their assumptions, is not a sufficient amount of money to make this fund viable beyond 1993. So that perhaps needs to be looked at further.

The other issue, then, is to what extent do the veterans pay and to what extent does the Government pay for whatever this amount of money is. I guess my question went to what do you feel is an appropriate amount with the continuing entitlement feature. I think you've answered it. I'm not asking you to state it over.

Mr. MCGUIRE. The entitlement thing is something I think only you can decide. We can't.

Mr. PAYNE. One other question, and this is for my friend, Jim Abbott. It's nice to see you again, Mr. Abbott.

You had mentioned that the market share of VA loans had dropped from 13 percent—I didn't catch exactly the dates—from 13 percent to 7.9 percent. Do you think that's primarily due to no-bids or are there other factors such as affordable housing and so forth that seems to have a lot to do with that?

Mr. ABBOTT. Affordable housing and an increase in interest rates certainly could have an impact on that. But I am confident that a number of lenders have made conscious decisions to strengthen their underwriting requirements on VA loans because of the no-bid

potentiality, and I know, quite frankly, we have done that, too. So, without question, the no-bid formula has had an impact on providing deserving veterans with home financing.

Mr. PAYNE. For instance, what would generally be the difference in terms of your underwriting standards? Is this more expensive to the veteran as a result of this?

Mr. ABBOTT. For instance, in our case, we may require that, after closing costs, the veteran has 2 or 3 months additional funds available for monthly payments, where maybe before we may have only required that they have only 1 month. The Veterans' Administration, under their guidelines, I think, may not have such a requirement. So it's just as general strengthening in the creditworthiness of the veteran applicant.

Mr. PAYNE. Let me ask one other question relating to the 5-percent downpayment. Mr. Owens, you mentioned that you were formerly known as "mobile homes". I know you now have homes that we think of as mobile homes and also other housing that is put together on a site.

Is there a differentiation between the various kinds of manufactured housing in terms of the downpayment?

Mr. OWENS. Only in the sense of how it's sited. You can get a VA loan using a manufactured house, for example, if it's permanently sited and the real estate that it's on and the home is all in one transaction. It essentially becomes a housing type loan, a mortgage loan, where instead of site-building the home, you're using a factory built type product. But, in general, it doesn't matter. You can have a very beautiful, multisectional home, and if it's sited in the traditional way—and I don't mean necessarily on the kind of foundation, but generally, just because the industry has grown up, in a sense, that the type of lenders who service the industry tend to make personal property as opposed to mortgage loans, you have to make the 5-percent downpayment. It is required in the program.

We understand why it was done. It was done to try to stem some of the losses in the program. I think it has had the effect of driving a lot of veterans out of the program.

Mr. PAYNE. Thank you very much.

Mr. JONES. Thank you.

Mr. McGuire, would you still oppose the indemnity feature of the bill if it were amended to state that the veteran will be indemnified against loss unless the loss to the VA is by fraud, by wrongful actions on the part of the veteran, such as misrepresentation or bad faith?

Mr. MCGUIRE. No, sir, I don't think we are. We would not be opposed to it under that basis. We have recommended that, if it's going to be done. We would agree with that.

Mr. JONES. Mr. Abbott, I had a question for you, too. In regard to the incentive to keep a loan current, we would assume that the loss of a home would play a large part in not defaulting on a mortgage. You state that consideration should be given to granting the VA the option to release veterans from liability on a case-by-case basis. That authority exists today but is not being used. There is no doubt that veterans today are being treated more harshly than their nonveteran counterparts.

What if we were to deny indemnity in instances of fraud, deliberate waste or equity skimming? What if we limited no-bids to instances of fraud, deliberate waste, or equity skimming on the part of the veteran, or gross faults on the part of the lender?

That's a lot of question.

Mr. ABBOTT. It really is. Let me just make reference back to the impunity question. We think there is a psychological motivation—there is some implied psychological motivation to the veteran, should there be some concern on his part that he would remain liable for those losses. On the other hand, we truly do believe it should be considered on a case-by-case basis.

In our case, we do everything we can to keep the veteran in the house. No one wins in a foreclosure situation. So we do provide for partial payments, we do allow for partial payments, and we do everything we can to provide work-out programs for the veterans should they go into default.

Mr. JONES. I thank you very much.

I apologize again. We have a vote and we're going to have to take a recess for about 15 minutes. Once again, I appreciate your patience and bearing with us on this. We will recess until about 1:30. Thank you very much.

[Whereupon, the subcommittee was in recess.]

Mr. JONES. Before we were so rudely interrupted, Mr. Abbott, you were responding to my question, and I know that you wanted to continue with that response.

Mr. ABBOTT. Thank you, Mr. Chairman.

Regarding the proposal that you made, in connection with those loans where fraud and other such activities were involved, while we, the MBA, don't have a specific policy on that yet, we feel we would be very much inclined to support something such as this.

I will just go one step further and say we lenders have given a great deal of focus in the last several years on enhancing our quality control and quality assurance programs, so there is no question we would support something such as this.

Mr. JONES. Thank you.

Mr. Irvine, you mentioned HUD's 3.8-percent premium. Their default experience has always been worse than the VA's. They are required to refund unused premiums to the mortgagors and they have accumulated substantial reserves. Would it ease your minds to know that the 2 percent indemnification fee came out of the same FHA model which arrived at their 3.8 percent mortgage insurance, and it was based on actuarial projections of the program's direction. Should the 2-percent fee prove to be wrong, it can always be adjusted later. Frankly, it is the principle that we are proposing.

I wonder if you could comment on that for us.

Mr. IRVINE. Thank you, Mr. Chairman.

I think if we're speaking to the issue of principle, we would go back and suggest that the 1 percent user fee shouldn't even be in place. Because if this is truly an entitlement program, we want to look at who the constituency is that benefits directly from this program. It is obviously your decision about how much the veteran should pay and how much the Government contribution should be to make the program actuarially sound.

Our concern is affordability. My own historical perspective on who we have loaned to and what kind of veterans have used the program through our firm, are typically veterans who are within 1 to 5 years of being out of the service. They have located in the Portland metropolitan area even though they didn't do their service there, because they feel there's an opportunity. During their tenure in the service, they haven't had an opportunity to save adequately for a downpayment. Maybe both husband and wife work, but the ability for them to put away money for a downpayment is very difficult, given housing costs and the nature of affordability today. And they come and they look at the program.

When you added 1 percent back in the early 1980's, that significantly affected the ability of veterans to be able to afford to buy a home, even at no down. By raising it 25 basis points, as Mr. McGuire stated, I'm not sure what that's going to do in terms of affordability. I think it's the issue of how much should the veteran pay and how much should there be through the entitlement.

We believe that the veterans program has played a major part in the issue of home ownership and housing affordability. It has given the veteran an opportunity to buy a home, where they otherwise wouldn't have been able to own a home. It has given them an opportunity to take a stake and play a major role in the community where they chose to live. I think that as the statistics have shown, in comparing the FHA default rate and the veterans default rate, that veterans are good risks and that, in fact, they feel responsible to society and don't go into default easily. Because of that, and considering what they have given to their country, I think it is little to assure they can have and own their own home, given the benefits accrued to society at large.

I know that's kind of skirting around the question, but that's my experience. Home ownership to these veterans, the people that buy the houses that I build, couldn't otherwise be able to buy that home. I think they have been in large part a major contributor to the Portland economy, the Portland tax base, and the community at large.

Mr. JONES. I thank you.

Congressman Parker from Mississippi.

Mr. PARKER. Thank you, Mr. Chairman.

Let me try to put in perspective how I look at things in a personal way. In any group, I don't care who it is, there are going to be some people that are going to try to beat you out of money. I don't care how good the group is or what wonderful virtues that group has, there are going to be some people that will try to beat you.

To give you an example, I had a situation in my district where we had an individual in FHA, where they had worked with him in every way. It wasn't a situation where he didn't make the money. It was a situation where he wouldn't pay the money. They redid his loan, added another $10, kept redoing it. He was not always always behind; he would wait until the last minute and then come in and do it again.

I told the FHA Administrator, the best thing for you to do is foreclose on that sucker, get him out, and let somebody have that house who cares about it and who needs a house. We've got too many people waiting for some deadbeat to come along.

Now you know where I'm coming from. I believe strongly that people have a right to certain things. Veterans certainly have a right to certain things. They also have a responsibility, and I believe strongly in that.

Now, you questioned the appropriateness of blanket indemnity in your statement. Yet you sell houses subject to mortgage guaranty insurance. I agree, there should be some exceptions to the concept of blanket indemnity for all mortgage loans. However, these exceptions should not be made on a case-by-case basis. The exceptions should be generally limited to cases of fraud, misrepresentation and willful default. You also state there would be little incentive for home owners to continue to pay for homes which are valued at less than the mortgage debt.

My question is this: Don't you think that the desire to keep one's home would serve as the strongest possible incentive to continue to pay for it?

Mr. IRVINE. Is that to me, Mr. Parker?

Mr. PARKER. Whomever.

Mr. IRVINE. Mr. Parker, if I understand you correctly, you're suggesting that there should be recourse to the veteran. We support that principle. We believe that, if there isn't recourse to the veteran directly, you will further undermine the soundness of the program.

Mr. Abbott commented about what the mortgage bankers are doing in terms of tightening up underwriting. I think that's the solution. You know, underwriting criteria is one-half of the equation, and the entitlement is the other half of the equation. The marketplace appears to be addressing the underwriting component. Again, the entitlement then should go ahead and flow through. However, I think, if I understand you correctly, if there is an entitlement that does not preclude the veteran from being responsible and that, in fact, the veteran ought to be fully culpable and have direct recourse to the veteran if the veteran chooses to default——

Mr. PARKER. That's exactly what I'm saying. I want everybody treated the same. I want them to be given every opportunity. But they do have responsibility, also. I don't want to relieve that responsibility. It's a two-sided sword.

Do you question the appropriateness of selling houses subject to mortgage guaranty insurance which provides similar protection as that offered in this bill?

Mr. IRVINE. Well, my position would be—and I think nationally, the home builders position would be—that it should be an option. If the market demands that there needs to be mortgage insurance because of the underwriting, then, in fact, there ought to be mortgage insurance. If you were going to offer it through this act, my suggestion is that it be part of a menu of various options that the veteran could elect and maybe pay something additionally for that.

I think it was the chairman that raised the question of being able to buy insurance, mortgage insurance, for a variety of reasons, based on health, based on disability and the like. That, again, is a menu that is available to people in the marketplace and I would suggest it would benefit the veterans and the Veterans' Administration to allow that to be an option. But I'm not sure you want to mandate it.

Mr. PARKER. Let me ask one other question: Upon what do you base the statement that indemnity provisions and user fees are precluded because this is an entitlement program?

Mr. IRVINE. Mr. Parker, again, I think it is the issue of entitlement. What is the entitlement? There can be a full entitlement, and traditionally, that full entitlement prior to 1983 was no fee, no user fee. You could buy the home for nothing down, including closing costs. That was a pretty good entitlement and that afforded many veteran families the opportunity of home ownership.

As you chip away—excuse me. That's not fair. As you redefine entitlement, you reduce the opportunity for home ownership. Now, one way is to add a user fee; one way is to scale the rate; one way is to enter into a negotiated rate. Traditionally, the National Association of Home Builders has opposed all of those various elements. As I said earlier, we are supportive of ensuring that a veteran is responsible and there should be direct recourse. But on the side of entitlement, the historical record is clear, that for a period of 40 years, this program operated as an entitlement program to veterans in this country, who served this country well.

Putting strong underwriting criteria on veterans is fine. I think you need to do that. But then it's your decision to determine how much of an entitlement you wish to grant. We would encourage that the entitlement stay at least what it is today. As I said earlier, we didn't like it when the Congress chose to enact a 1 percent user fee. But it happened. But, as the realtors have cited, that affected housing affordability for the veteran. Again, it's an issue of entitlement, and I think that decision is yours.

We are very concerned—and I'm sure that you all understand what has happened in terms of home ownership rates in America. Up until 1978, they continued to climb. In 1978 they started to dip down. In the age bracket of 24 to 35 we've had an 8-percent reduction in home ownership rates. In the next 4 years, it is anticipated that 50 percent of those that are going to enter the home-buying market cannot afford to buy a home. Some of those households are veterans. It's the decision of this committee and this Congress to make a determination on how much you want to help those veterans and prioritize the opportunity of home ownership for those veterans.

Again, I'm sorry for a long-winded answer.

Mr. PARKER. No problem.

Mr. Owens, there is one thing I would like to tell you. They have mobile homes for sale in Alexandria. They're vertical. They don't have wheels on them, and they sell them for about $300,000. They call them townhouses.

[Laughter.]

Mr. McGuire, one thing I would like to point out. I went to Houston on a trip for this committee, and we met with the representative down in Houston for the Realtors Association. The work that they're doing, as far as the partnership between the VA and the local realtors, has been phenomenal. They have really added a lot to the market down there and they have been able to turn a lot of things around that they would not have been able to do without the advice and counsel of private entrepreneurs. I mean, it's an extremely impressive thing. I want to thank all of you for being here.

Mr. Chairman, thank you very much.

Mr. JONES. Thank you.

On behalf of Chairman Staggers and the entire subcommittee, we would like to thank you for being here today, for your testimony, and assure you this will be extremely valuable to us as we consider this piece of legislation. We appreciate it.

The next panel is going to consist of Mr. Richard W. Johnson, director of legislative affairs, the Non Commissioned Officers Association; Mr. Steve A. Robertson, assistant director of the National Legislative Commission, the American Legion; Mr. Richard F. Schultz, associate national legislative director for the Disabled American Veterans; Mr. Dennis Cullinan, assistant director, National Legislative Service, Veterans of Foreign Wars; Mr. John Bollinger, associate legislative director of the Paralyzed Veterans of America; and Mr. Paul Egan, director of legislative affairs, Vietnam Veterans of America.

Gentlemen, we welcome you all here today and thank you for appearing with us. Let's start in the order you were introduced, which is Mr. Johnson, please.

## STATEMENTS OF RICHARD W. JOHNSON, JR., DIRECTOR OF LEGISLATIVE AFFAIRS, NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA; STEVE A. ROBERTSON, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION; RICHARD F. SCHULTZ, ASSOCIATE NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS; DENNIS M. CULLINAN, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES; JOHN C. BOLLINGER, ASSOCIATE LEGISLATIVE DIRECTOR, PARALYZED VETERANS OF AMERICA; AND PAUL S. EGAN, LEGISLATIVE DIRECTOR, VIETNAM VETERANS OF AMERICA

### STATEMENT OF RICHARD W. JOHNSON, JR.

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Chairman, the frailties of the Loan Indemnity Act of 1989 and the program have been well-defined I think by previous witnesses. Accordingly, I will limit my remarks to those changes in the act which NCOA would support.

First, the Association would suggest an equalization of the fee distribution between the veteran and the Government. NCOA sees no reason at this point to increase the fee that the veteran pays for a home loan, certainly not to redistribute payment of the program to a 62½ percent to 37½ percent ratio in favor of the Government.

Secondly, NCOA would like to see all loans treated the same. In essence, what I'm saying is we do not support the provision which would provide a discounted loan for those who have a little cash together that can make a downpayment.

Third, the Association would like to see exemption for disabled vets continued as it is under the current program to cover all disabled veterans.

Fourth, the Association would like to see a provision added to the legislation to allow that any surplus of funds in the program be in-

vested in reopening direct loans for its potential to create income for the program.

Fifth, should the reserves become such that it is possible to lower the participation fees, we would prefer to see a provision in the legislation which would limit any reduction in fees to veterans first and the Government second, so that we don't have veterans continuing to pay once the Government has given up or has supplemented the need to make a contribution itself to keep the program operating.

Finally, with regard to the 90 percent sale provision, NCOA continues to oppose loan sales for the Veterans' Administration at below face value. To give a quick example, a loan sale that was conducted about 6 weeks ago by the Veterans' Administration, $278.1 million in portfolio assets were liquidated for $255.9 million, a 90 percent sale. However, the Veterans' Administration got only 58 percent in cash, $161 million. They were forced to take the rest in subordinate certificates, paper, which is worth $94 million only if all those loans become good.

The best estimate—and I have talked to several people about this—the Veterans' Administration could not, in their wildest imagination, hope to ever see the $94 million. They will see a percentage of that, but, at best, it has been suggested that that sale might run 74 to 76 percent, once the defaults are taken out of the subordinate certificate end that the Veterans' Administration holds. As a result, the Department of Veterans Affairs, which shows a 90 percent loan sale as a matter of record, is most likely to receive something between 58 percent and 90 percent, which will never be reflected in the public record.

With that, Mr. Chairman, in deference to the time, I will conclude my oral remarks. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Johnson appears at p. 118.]

Mr. JONES. Thank you, Mr. Johnson. Again, in the interest of time, we will withhold our questions until the entire panel has testified.

Mr. Robertson, we would appreciate your comments now.

## STATEMENT OF STEVE A. ROBERTSON

Mr. ROBERTSON. Thank you, Mr. Chairman. Thank you for inviting us here to testify today on H.R. 1415. Since our written statement is going to be submitted, I, too, will make this rather brief.

The opportunity for a veteran to become a home owner has been a priority of The American Legion for many years. Since our sponsorship of the Servicemen's Readjustment Act in 1944, we have continued to support legislation which would help veterans reach this goal.

Currently, we realize the program is a big financial problem to the Government. We feel that it is time to take some positive actions, and we feel that H.R. 1415 is a positive step in the right direction.

We continue to oppose the user fee as a privilege to use a program that we feel that we are already entitled to. H.R. 1415 does

seem like an acceptable alternative for both the veteran and the taxpayer.

Thank you very much.

[The prepared statement of Mr. Robertson appears at p. 121.]

Mr. JONES. Thank you very much. Now we will hear from Mr. Schultz of the Disabled American Veterans.

## STATEMENT OF RICHARD F. SCHULTZ

Mr. SCHULTZ. Thank you, Mr. Chairman. Initially, I would like to thank you and the members who have stayed here today to listen to our testimony. We appreciate you coming back as many times as you have.

First off, I would like to say that the DAV supports H.R. 1415, except that provision which would require the 10 and 20 percent service-connected disabled veterans to pay the mortgage indemnity fee.

We realize the program has some fiscal problems. We have never supported the user's fee, but we recognize that in order to keep the program solvent some funds had to be made available to the revolving fund.

We have heard a lot today about how the veteran should share some risk in this program. Realizing it is an entitlement program, I think the risk was right up front while veterans served their country. I think some very good points have been made, also to say that veterans generally are not any different than anyone else. They want to stay in their homes. Just because there's an indemnity clause, this doesn't mean they're going to cut and run at the first sign of any problem.

Along that same line, I think a lot more can be done in servicing loans, keeping veterans in their homes. I realize the committee here has done a lot of work in that area. There has been recently legislation introduced to beef up the loan servicing. There are estimates that that will save a lot of money and at the same time provide a good service for veterans.

I might also point out that the veterans who now are the ones who have to pay as far as on a default, overpayments and anything created within the Veterans' Administration for the most part, as has been pointed out here today, are service-connected disabled veterans, because those are the ones they look at for any future assets that they may be able to attach. Along that line, I would have to say the provision dealing with the waiver contained in the bill, Section 5, we strongly support that.

In the absence of fraud, the VA generally looks at a couple of criteria, one, the ability to repay at some future date, and the other is the degree of which they were at fault in creating the overpayment or, in this case, in the home loan default. So we certainly support that provision.

I might also add that there has been some discussion on whether or not this program is going to make any money, whether it's going to keep the program solvent. I think the Peat Marwick study says that it won't, and I think CBO says between 1991 and through 1993, there will be more than a billion dollars saved to the Federal

Government. I think in light of the work that has gone into the CBO estimates, I would tend to put a little more credence in that.

With that, I would just like to thank you again for the opportunity to appear here today, and I would be glad to answer any questions you may have.

Thank you.

[The prepared statement of Mr. Schultz appears at p. 125.]

Mr. JONES. We thank you, Mr. Schultz.

Mr. Cullinan.

## STATEMENT OF DENNIS M. CULLINAN

Mr. CULLINAN. Thank you, Mr. Chairman. In view of the time, I will speak very briefly.

The Veterans of Foreign Wars supports H.R. 1415, inasmuch as it would serve to strengthen and preserve a program that has proven to be an invaluable asset to both veterans and the Nation, while providing the veteran with highly desirable additional mortgage protection in the event of foreclosure. Even so, we would emphasize that we may only back this proposal with the understanding that, once the DVA home loan program has been restored to financial health, the mortgage indemnity fee itself be eliminated. The VFW has long opposed the user fee and we recognize this legislative proposal as a means of both strengthening the Home Loan Programand sustaining its life while providing a means of eliminating a fee to veterans all together.

Taken as a whole, the VFW views the legislation to establish a new and financially independent Home Loan Program as an innovative initiative which is certainly moving in the right direction towards the fulfilling of a current VFW resolution that asks that legislation be introduced that will serve to maintain the VA Home Loan Guaranty Program as the most viable and desirable means of home financing for veterans.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Cullinan appears at p. 129.]

Mr. JONES. Thank you, Mr. Cullinan.

I now would like to hear from Mr. John Bollinger of the Paralyzed Veterans of America.

## STATEMENT OF JOHN C. BOLLINGER

Ms. BOLLINGER. Thank you very much, Mr. Chairman. We appreciate the opportunity to express our views today.

We are most supportive of the legislation. As you know, we supported it last year when it was introduced in the 100th Congress and passed by the House last September. We believe the implementation of the bill is critical to the long-term solvency of the program. We also believe that the sooner H.R. 1415 is implemented, the better chance DVA will have of eventually coming to grips with the billion dollar appropriations that have been necessary in recent years. So we are very optimistic about the proposal. We believe it will give DVA a fresh start down the road toward fiscal solvency in that program.

I would like to comment on several provisions of the bill and then discuss what the future might hold if this legislation is as successful as we all hope it will be, and as CBO predicts.

For the veteran, the establishment of the 1¼ percent indemnity fee lies at the heart of the program. We believe that fee is a comparatively small premium to pay for the indemnity provision. The draft bill also includes exemption of veterans who have been rated 30 percent. PVA supports that segment of the bill.

We are in agreement with the Government contributions and other fees as spelled out in the provision, especially early on in the program, as the indemnity program gains its financial footing. We do have one concern, and that is that over the years veterans have been asked to pay more and more in the form of fees and contributions and copayments and so on. We would simply like to say that we encourage the subcommittee to closely monitor the necessity of the indemnity fee and to make adjustments accordingly as the program becomes financially successful.

In conclusion, I would just reiterate our support. I believe that H.R. 1415 does indeed represent the future of the program which, since 1944, has been tremendously successful. So we encourage the subcommittee to try to get it on the fast track and we're behind you all the way in that regard.

Thank you.

[The prepared statement of Mr. Bollinger appears at p. 132.]

Mr. JONES. I appreciate that support, Mr. Bollinger.

The last member on this panel is Mr. Paul Egan of Vietnam Veterans of America.

## STATEMENT OF PAUL S. EGAN

Mr. EGAN. Thank you very much. I would like to make a couple of opening general comments.

First of all, we, like the Non Commissioned Officers Association, prefer a recapitalization option to indemnification. The reason for that is basically in line with restoring or bringing back the entitlement character of this particular program.

After having said that, though, we would certainly agree with the remarks by the American Legion, that H.R. 1415 is a good bill. It is a good bill because the VA's Home Loan Program has become what it has become in the last several years and because the overall real estate industry has become what it has become over the last many years.

With regard to the program itself, we are all well aware of the sale of the loan portfolio that was an income-generating mechanism for the program. We have seen high foreclosure rates beginning back with the very deep recession of the early 1980's. We have seen those foreclosure rates continue at unacceptably high levels, not only in the oil belt but unacceptably high elsewhere as well.

We have seen as a result of this the requirement of large infusions of appropriations that it is not likely the Congress will for long continue to support. And I think we have seen some rather poor VA management of the program with regard to marketing the inventory of foreclosed properties.

On the other hand, we have seen within the program the initiation of a half percent user fee, and then a 1 percent user fee, and now we're talking about an indemnification fee that at least provides some benefit—that's positive. Within the same bill we're even talking about downpayments, which has never been discussed before, and we're kind of skeptical about that.

But with regard to the real estate industry, we would all have to be pretty naive not to have noticed that property values have skyrocketed tremendously in the last several years. To accommodate affordability of housing, given those increased housing costs, it has been necessary to find some rather creative ways to facilitate affordability. We have seen the 30-year mortgage give way to the 40-year mortgage. We have seen adjustable rate mortgages, we see equity sharing, all those kinds of things that basically make the unaffordable affordable.

I have to believe that the proprietary interests that gain from this program—for example, the realtors are going to show a buyer a property that's going to take them to the very maximum of what they can afford, so you have a situation where we believe a lot of the veterans who are in default, who are being foreclosed, are not deadbeats, not people who are guilty of fraud or misrepresentation. They are people that are simply in a little deeper than perhaps they ought to be. That's a shame, but as property becomes increasingly unaffordable and the desire continues to be to get into some property, we're going to continually see the lure of some of these creative mechanisms. And there's nothing we can do about it. So, the facts being what they are, indemnification is perhaps a must.

I would say, however, by way of making a recommendation, that to date it has been the veteran that has paid for the problems in this program. Maybe we ought to begin to explore ways in which some of the cost for indemnification can be borne by the proprietary interests that make a profit from this program.

The other final suggestion—and I make this very seriously—is that this program really isn't a readjustment program any more. As long as we're going down this trail, where we're going to provide indemnification, why don't we add something to H.R. 1415 that would give it a readjustment feature. In addition to exempting from the indemnification fee those individuals who are 30 percent or more disabled, why don't we additionally provide an exemption for first time home buyers? As far as we're concerned, if that means an increase in the indemnification fee for some, that's fine with us. But I think if we're interested in trying to make housing affordable for veterans well into the future, at least we have an obligation to take care of those veterans at the bottom of the totem pole, the first time home buyers.

That concludes my statement.

[The prepared statement of Mr. Egan appears at p. 135.]

Mr. JONES. Thank you very much.

I have, I suppose, a generic question that anyone can answer. Do you agree that some modification of the statutory language authorizing waivers is necessary to force the Department of Veterans Affairs to administer the provision beneficially?

Mr. SCHULTZ. Mr. Chairman, if I may, yes, we believe that to be true, especially in light of what we see frequently, where a waiver

claim is denied for service-connected disabled veterans in receipt of compensation on the basis that they have the ability to pay. If that's not carried across the board to everyone—Well, even if they do carry that same thing across the board to everyone for the most part, it's the service-connected disabled veteran that pays. I think that now, once they find even a partial fault on the part of the veteran, the next step is they will deny the waiver on that basis and then look at the ability to pay.

So yes, we believe a change needs to be made to that. In the absence of fraud, I think they need to look at the equity, whether or not it's good for the individual today and not into the future, because if we're going to look into the future for these individuals, then we need a crystal ball and, for the most part, we then couldn't waive any overpayments. I think the equity has to be put back into it, where they have to look at what happens today to that individual and his future.

Mr. JOHNSON. We concur in that wholeheartedly, and would also suggest the VA look to reducing the indebtedness of the veteran by the amount of any fee previously paid. We would also suggest the VA reexamine its provision on recapture that provides them a 10.84 percent automatic cut off the top on any loan forfeiture, to review whether those figures are really justified in creating the indebtedness on the part of the veteran in the first place.

Mr. JONES. I thank you all very much.

I hope you will forgive me. I have to depart now for a commitment that I could not reschedule. Congressman Payne of Virginia is going to assume the chair. But I would like to say personally to all of you that I thank you very much for your testimony here today. It has been extremely valuable to us and will be deeply considered. We appreciate it.

I also personally, on behalf of the 76,000 veterans in the Fourth District of Georgia, I want to tell you how much I appreciate the work that you do as advocates on their behalf. I thank you all.

Mr. PAYNE (presiding). I only have two questions, which are again general in nature.

One has to do with the whole notion that we talked about earlier, entitlement versus the actuarial soundness. It seems that a lot of decisions are being looked at to push it maybe away from what we feel the veterans are entitled to and toward how it should be actuarially sound. What I hear many of you saying is that you understand the position and predicament that we find ourselves in, and we appreciate that, because it is a difficult situation in terms of the amount of money we're looking at, in terms of the needs of veterans, hospitalization and other areas.

But you are also saying that should this situation turn around, and we hope that it will, this should be reversible or there should be, maybe not a sunset in terms of a date, but the notion that should it turn around, the veterans would come out first so to speak and not have to continue to pay into something that would no longer be necessary.

Again, this is just a general question. Does that represent the consensus of all of you?

Mr. JOHNSON. Certainly ours, Mr. Chairman. If you go back in history and look at the beginning of this program, each veterans

home loan was accompanied by a $300 loan forgiveness. The Government actually contributed $300 to the purchase price of the veteran's home when this program first started.

Now we have come completely the opposite. We are charging veteran participants, really taxing veteran participants, for participation in the program.

This Veterans Home Loan Guaranty Program has, I think, a social purpose that far exceeds the benefit to veterans and its benefit to the Nation: what it has added to the tax base in communities across the country, what it has made possible in the mortgage banking industry, and what it has made possible in the building industry. All these things far outweigh the individual benefit to the individual veteran in the larger scope of things as we look at it.

Certainly the individual veteran benefits from the program, and we think he should continue to do so, and we think it should be preserved as an entitlement program without a charge for participation.

Mr. CULLINAN. Mr. Chairman, I would reaffirm the VFW's view that the Home Loan Program is an entitlement program, and we recognize this particular measure before us today as being a means of reasserting that fact. Right now, very large appropriations are required to maintain the program. We see that as being a threat to the program's very existence. But it is an entitlement program and we very much wish to see all fees eliminated to the veteran.

Mr. SCHULTZ. Mr. Chairman, I have to say the same thing. The DAV believes this is an entitlement program that veterans should not be charged for the use of. However, recognizing the fiscal problems that the loan guaranty program has, we certainly understand this approach. It is far better to indemnify, we believe, than to just charge a fee for nothing, so to speak.

Also, I would agree that, should the program become solvent, or when it becomes solvent, then we could do away with that fee that veterans are charged.

Ms. BOLLINGER. PVA concurs, Mr. Chairman. I would reiterate that we feel the fee is necessary now, but we would like to see you closely monitor that fee as the program matures, and hopefully, if possible, eliminate or lower the fee.

Mr. EGAN. The fee, without being an indemnification, to use sort of Richard Darman's remarks, if it looks like a duck, it is a duck. When it was just a funding fee, it certainly looked like a tax and it was a tax. At least this provides veterans with some kind of protection.

As for the entitlement nature of the program, sure, it's an entitlement. We would like to see all the funding fees, whether they be indemnification or otherwise, removed. But just like in VA health care, all category A veterans are entitled to care but not all of them are getting it. The ease with which this program can be used has everything to do, in our judgment, with whether it is or isn't an entitlement.

The rule of thumb any more is that the closing costs are going to cost you 5 percent of the value of the property. If you opt for the half off the indemnity fee sale in H.R. 1415, you're going to talk about 10 percent. If you add the other ¾ percent or ½ percent, you're talking about a lot of up-front money. So, sure, if there is

something that can be done to use the cost, it should be done. The ease with which the program can be used is the most important thing.

Mr. ROBERTSON. Sir, it seems that we are kind of losing ground. I remember when I came in the service--I'm not as old as these other guys—when I came in the service in '73, all the benefits were there. I had my education taken care of, I had the opportunity to buy a home. My father got his degree thanks to the GI bill, and he bought our first home with the home loan program. I'm beginning to wonder what is going to be the incentive for the next generation of veterans coming up. Hopefully, we're not going to start another war to where they have to come in. But that incentive has got to be there and we're losing ground on that very quickly.

Mr. PAYNE. I think that's a point well taken. I know I was the recipient of the GI bill which allowed me to go back to graduate school and I bought my first home with a VA loan. These were really important to me personally. I can very much relate to the concern, but also very much relate to the dilemma we find ourselves in in terms of the fiscal realities.

Let me ask one other question, and I think this also goes to maybe a broad question, and that has to do with indemnification. You all said this is palatable because there is the indemnification provision, and without that, it would certainly be much less so, if at all. We have talked some today about blanket indemnification and we have said there are certain instances perhaps—we mentioned fraud and abuse and so forth—as those cases where people perhaps should not be indemnified.

Do you all have opinions about blanket indemnification versus some of those other factors being considered?

Mr. JOHNSON. It's going to be a difficult law to write, Mr. Chairman. We would certainly not like to see the individual who is trying to skim equity escape from some indemnity in that, but who do you go back to? Generally when you have an equity skimming, it is not the veteran who has done it, who would be liable under the law. It is somebody who has assumed his or her loan.

Yes, we would support retained liability for certain individuals where fraud and abuse is involved. I'm just not quite sure how you're going to write that to equitably treat the veteran and to keep the veteran, if he is, in fact, a victim as much as the Government is on an equity skimming scheme, from becoming a victim of the Government himself.

Mr. SCHULTZ. Mr. Chairman, I can say, as far as the DAV is concerned, we certainly wouldn't support indemnifying someone who has deliberately committed a fraud. I would also agree that we surely would have to take a look at what is defined as fraud and misrepresentation and those sorts of things. So to give you a straight yes or no answer is very difficult. But I can say we certainly would not support indemnifying anyone who is guilty of fraud against the system.

Mr. EGAN. I would agree with that, except that I would want to remind the committee, in its considerations of whatever criteria it wants to use, whether it be fraud, misrepresentation or whatever, that this hearing has heard some fairly spectacular testimony from its second witness, Mr. Leen, from Washington State, articulately

characterized the way in which the VA hounds veterans for deficiencies, something that isn't going on in other Federal mortgage programs.

If you want to say that we're not going to indemnify people who are found to have been engaged in fraud or misrepresentation, that's fine, but let's be sure we define what those things are, because if the VA misinterprets or finds a way to misinterpret a condition of indemnification, they will do so. We have to be very clear about what we're exempting here.

Mr. CULLINAN. Mr. Chairman, we support mortgage indemnification as a general principle, and we also support as a general principle that deliberate wrongdoers should not be coddled or rewarded. I would agree with Mr. Egan, and I believe with everyone here, that we would have to be very careful in assessing the criteria of what constitutes a wrongdoer. But certainly someone who deliberately defrauds the Government should not be exempt from the liability.

Mr. PAYNE. Once again, I would like to thank, on behalf of Chairman Staggers and the rest of the committee, all of you for being here and staying so long to do this. It has certainly been very helpful. We will continue to consult as we proceed with this very important legislation.

Thank you very much. The hearing is adjourned.

[Whereupon, at 2:20 p.m., the heading adjourned.]

# APPENDIX

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HONORABLE HARLEY O. STAGGERS, JR.

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

H.R. 1415

APRIL 18, 1989

THE SUBCOMMITTEE WILL BE IN ORDER

SINCE ASSUMING THE CHAIR OF THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS, I HAVE SCHEDULED SEPARATE MEETINGS WITH MANY OF YOU WHO WILL BE TESTIFYING LATER THIS MORNING TO DISCUSS THE HOME LOAN GUARANTY PROGRAM AND WAYS TO KEEP IT VIABLE.

I TOLD YOU THAT I WOULD INTRODUCE MORTGAGE INDEMNITY LEGISLATION, WOULD AWAIT THE RESULTS OF THE PEAT MARWICK STUDY AND WOULD CAREFULLY CONSIDER ANY NEW RECOMMENDATIONS TO PUT THE PROGRAM ON A SOUNDER FINANCIAL FOOTING AND STILL KEEP THE ENTITLEMENT NATURE OF THE PROGRAM INTACT.

UNDER CURRENT LAW, VETERANS MUST PAY A 1% USER FEE IN ORDER TO GET A LOAN. UNDER H.R. 1415, VETERANS WOULD PAY AN ADDITIONAL 1/4% FEE. IN ADDITION, THE FEDERAL GOVERNMENT WOULD SUPPLEMENT THIS FEE BY 3/4% OVER A THREE YEAR PERIOD. THE VETERAN WOULD BE RELIEVED OF LIABILITY IN THE EVENT OF FORECLOSURE. THE CONGRESSIONAL BUDGET OFFICE ESTIMATES THAT THIS WILL GENERATE SAVINGS OVER THE EXISTING PROGRAM.

SERVICE-CONNECTED DISABLED VETERANS RATED 30% OR MORE WOULD BE EXEMPT FROM PAYING THIS FEE AND VETERANS WITH DOWNPAYMENTS OF 5% OR MORE WOULD PAY A 3/4% FEE, THE SAME AS THE FEDERAL GOVERNMENT CONTRIBUTION. I WISH TO EMPHASIZE THAT THIS IS BASICALLY A FUNDING INITIATIVE. THE GUARANTY AGREEMENT WOULD STILL BE IN EFFECT TO LENDERS SO THAT THE BASIC OPERATION OF THE PROGRAM REMAINS INTACT.

THE BILL WOULD AUTHORIZE THE SALE OF ITS LOAN PORTFOLIO WITH OR WITHOUT RECOURSE AS LONG AS 90 PERCENT OR MORE WAS RECEIVED AT TIME OF SALE. SEVERAL OF THE VA'S NON-RECOURSE LOAN SALES RESULTED IN THEIR RECEIVING APPROXIMATELY 56 CENTS ON THE DOLLAR AT TIME OF SALE. AT A TIME WHEN THIS PROGRAM IS EXPERIENCING SEVERE FINANCIAL DIFFICULTY, THIS TYPE OF SALE MAKES NO SENSE AT ALL.

THE BILL WOULD ALSO MODIFY THE EXISTING REFINANCING LOAN PROVISIONS TO ALLOW FOR EASIER REFINANCING OF CONVENTIONAL LOANS AND WOULD RE-EMPHASIZE THE EQUITY AND GOOD CONSCIENCE DEBT WAIVER PROVISIONS OF TITLE 38. THIS PROVISION IS DESIGNED TO REFOCUS THE VA'S ATTENTION ON THE CURRENT LAW'S BENEFICIAL AND EQUITABLE INTENT.

WHEN SOME OF OUR WITNESSES TESTIFIED ON THE LOAN GUARANTY PROGRAM EARLIER THIS YEAR, THEY URGED THAT WE AWAIT THE FINAL RESULTS OF

THE PEAT MARWICK STUDY BEFORE SCHEDULING HEARINGS. I HONORED THIS REQUEST. THERE IS NO DOUBT, HOWEVER, THAT THE RESULTS OF THE PEAT MARWICK STUDY ARE VERY DISAPPOINTING. THERE ARE RECOMMENDATIONS FOR INCREASED USER FEES UP TO 4.5%, INTEREST RATE SURCHARGES AND CAFETERIA OPTIONS WHICH ARE ALSO DESIGNED TO COST THE VETERAN MONEY. FRANKLY, I CAN'T SEE THAT THERE IS ANYTHING IN THIS STUDY WHICH COST $250,000 THAT IS OF ANY VALUE. THE MAJORITY OF THESE RECOMMENDATIONS NEGATE THE CURRENT BENEFICIAL ASPECTS OF THE PROGRAM AND IF ADOPTED, WOULD MAKE THIS PROGRAM LESS ATTRACTIVE THAN FHA OR CONVENTIONAL LOANS.

THE PEAT MARWICK STUDY ALSO ANALYZED THE MORTGAGE INDEMNITY LEGISLATION. THEIR PROGNOSIS ON THIS LEGISLATION WAS SOMEWHAT GLOOMY BUT THAT IS NOT SURPRISING SINCE THEY PROJECT AN 11% FORECLOSURE RATE. THIS IS SUBSTANTIALLY HIGHER THAN EVER EXPERIENCED IN VA'S HISTORY INCLUDING THE PROBLEMS IN HOUSTON AND OTHER PLACES ASSOCIATED WITH THE OIL

INDUSTRY. MOREOVER TIGHTER UNDERWRITING AND AN UPSWING IN ECONOMY SHOULD DECREASE THE FORECLOSURE RATE -- NOT INCREASE IT.

I AM PLEASED THAT MOST OF OUR WITNESSES HAVE SUBSTANTIALLY SOFTENED THEIR POSITION ON THIS LEGISLATION. I BELIEVE THEY UNDERSTAND THE CONSTRAINTS UNDER WHICH WE ARE OPERATING AND REALIZE THAT OUR MAIN INTENT IS TO KEEP THIS A GOOD AND WORKABLE PROGRAM.

STATEMENT BY THE
HONORABLE DAN L. BURTON

SUBCOMMITTEE ON HOUSING
AND MEMORIAL AFFAIRS

APRIL 18, 1989

GOOD MORNING, MR. CHAIRMAN. I LOOK FORWARD TO WORKING WITH YOU IN OUR EFFORT TO IMPROVE A FUNDAMENTAL VETERAN BENEFIT, WHICH HAS SERVED ALMOST 13 MILLION VETERANS AND THEIR FAMILIES. THIS SUBCOMMITTEE HAS BEEN CALLED UPON TO EXAMINE THE OPTIONS AVAILABLE TO PROVIDE THE VETERAN'S HOME LOAN GUARANTY PROGRAM WITH A STABLE AND SOLVENT SOURCE OF FUNDING.

IN LIGHT OF THE CONTINUING EFFORT TO CONTROL THE FEDERAL BUDGET DEFICIT, WE CAN NOT CALL ON THE TREASURY FOR BILLIONS IN EXTRA APPROPRIATIONS EVERY YEAR. WHILE ALL THE MONEY IN THE WORLD CAN NOT PAY BACK THE DEBT THIS

NATION OWES TO ITS VETERANS, THE HOME LOAN GUARANTY FUND OPERATED FOR NEARLY FOUR DECADES ON A REVOLVING FUND. WE MUST NOW FIND SOME WAY TO INSURE CONTINUED USE OF THIS BENEFIT BY FUTURE VETERANS.

MR. CHAIRMAN, I BELIEVE WE WOULD AGREE THAT THE SOLUTION TO THIS FUNDING PROBLEM IS NOT ONE, SIMPLE ANSWER, BUT RATHER A COLLECTION OF EFFORTS. ALONG WITH THE INCREASED FUNDING NEEDED, WE MUST LOOK AT THE EFFICIENCY OF THE PROGRAM, LOAN AND DEFAULT SERVICING, INCREASED LOAN SERVICING PERSONNEL, PROPERTY REHABILITATION, MANAGEMENT AND DISPOSAL, AND A MORE REALISTIC UNDERSTANDING OF THE PROGRAM RISK AND POTENTIAL.

TODAY, THIS SUBCOMMITTEE MEETS TO EXAMINE THE OPTION OF MORTGAGE INDEMNITY, WHICH WAS SPONSORED LAST SESSION BY ONE OF OUR WITNESSES, THE HONORABLE MARCY KAPTUR, DURING HER DISTINGUISHED SERVICE ON THIS SUBCOMMITTEE, AND SPONSORED THIS SESSION BY OUR HONORABLE CHAIRMAN. AS PROPOSED, MORTGAGE INDEMNITY OFFERS A MEANS FOR ESTABLISHING LONG RANGE SOLVENCY, AT THE COST OF A SHORT TERM APPROPRIATION EXPENDITURES AND AN INCREASE IN PROGRAM FEES FOR OUR VETERANS.

WHATEVER THE SOLUTION, OUR GOAL MUST BE TO MAINTAIN THE LOAN GUARANTY PROGRAM AS THE BENEFIT WAS DESIGNED TO BE: A

MEANS FOR PROVIDING AFFORDABLE HOUSING AND FINANCING SOURCE FOR OUR FORMER SERVICEMEN, WHILE KEEPING THE APPROPRIATIONS TO AN ACCEPTABLE LEVEL. AS WITH ANY SOLUTION, THERE ARE CERTAIN RISKS TO BE EXAMINED AND RESERVATIONS TO BE NOTED.

MR. CHAIRMAN, THANK YOU FOR YOUR LEADERSHIP ON THIS ISSUE. I LOOK FORWARD TO HEARING FROM OUR DISTINGUISHED WITNESSES WHO HAVE TAKEN TIME TODAY TO SHARE WITH US THEIR SUGGESTIONS AND VIEWPOINTS ON MORTGAGE INDEMNITY LEGISLATION. I AM CONFIDENT THAT THE COMMITTEE IS WORKING IN THE RIGHT DIRECTION TOWARD INSURING THAT FUTURE VETERANS WILL BE ABLE TO TAKE ADVANTAGE OF THIS BENEFIT TO PROVIDE HOUSING FOR THEMSELVES AND THEIR FAMILIES.

STATEMENT OF CONGRESSMAN CLAUDE HARRIS
BEFORE THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
APRIL 18, 1989

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO COMMENT TODAY ON THE PROPOSED LEGISLATION, HOUSE RESOLUTION 1415. THIS LEGISLATION, THE VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1989, WILL RESTRUCTURE THE VETERAN ADMINISTRATION'S HOME LOAN GUARANTY PROGRAM.

MORE THAN 13 MILLION VETERANS HAVE RECEIVED VA HOME LOANS TOTALING MORE THAN $321 BILLION DURING THE LAST 42 YEARS. THIS PROGRAM ENABLES A VETERAN TO REALIZE THE AMERICAN DREAM OF "OWNING ONE'S OWN HOME." THE FEDERAL GOVERNMENT PROVIDES A GUARANTY ON THE MORTGAGE SO THAT RETAIL BANKERS WILL MAKE THESE LOANS. THESE LOANS CAN BE USED TO PURCHASE RESIDENTIAL UNITS, HOMES, CONDOMINIUMS, AND MANUFACTURED HOUSING. IN THE CASE OF DEFAULT, THE REVOLVING FUND MAY BE LIABLE FOR THE VALUE OF THE LOAN. HOWEVER, IN THIS COMMITTEE WE HAVE HEARD MANY WITNESSES TESTIFY THAT MORE SERVICING BY THE VETERANS ADMINISTRATION CAN FORESTALL DEFAULT AND FORECLOSURE. FOR INSTANCE, THE EXTRA PERSONNEL IN THE HOUSTON OFFICE HAVE SHOWN PROGRESS IN LOWERING THE FORECLOSURE RATE FOR THIS DEPRESSED ECONOMIC AREA.

EFFECTIVE OCTOBER 1, 1982 THE CONGRESS AND THE PRESIDENT AGREED TO ESTABLISH AN ORIGINATION FEE OF ONE HALF OF ONE PERCENT TO HELP TO DEFER THE COSTS OF DEFAULTED LOANS IN THE REVOLVING FUND. IN 1984, THAT FEE INCREASED TO ONE PERCENT. ALTHOUGH SERVICE-CONNECTED VETERANS WITH 10% DISABILITY RATING

OR ABOVE RECEIVE A WAIVER ON THESE FEES, MANY VETERANS HAVE EXPRESSED THEIR OBJECTIONS TO ME ABOUT PAYING THESE FEES. THE PROPOSED LEGISLATION WOULD INCREASE THESE FEES BY A SMALL AMOUNT. IN EXCHANGE FOR THESE INCREASED FEES, THE VETERAN WOULD QUALIFY FOR MORTGAGE INDEMNITY OR MORTGAGE INSURANCE.

LAST SESSION, IN THIS COMMITTEE, COMMITTEE MEMBERS DISCUSSED THIS APPROACH AS A MECHANISM TO SOLVE THE RAPIDLY DETERIORATING STATUS OF THE HOME LOAN REVOLVING FUND. THE LEGISLATION PASSED IN OUR COMMITTEE AND THE HOUSE, BUT WAS NOT CONSIDERED IN THE SENATE. ALTHOUGH I HAVE NOT SUPPORTED THIS LEGISLATION IN THE PAST, I LOOK FORWARD TO HEARING FROM THE WITNESSES TESTIFYING TODAY. I REMAIN CONCERNED WHETHER THIS IS THE BEST WAY TO MAKE THE REVOLVING LOAN FUND SOLVENT IN THE COMING YEARS. CERTAINLY, SOME NOVEL APPROACH SUCH AS THIS ONE WILL BE NECESSARY TO REPLACE THE INFUSION OF CASH THAT WE HAVE SECURED IN THE PAST BUDGETARY CYCLES TO KEEP THE FUND SOLVENT.

STATEMENT OF

R. J. VOGEL

CHIEF BENEFITS DIRECTOR

DEPARTMENT OF VETERANS AFFAIRS

BEFORE THE

SUBCOMMITTEE ON

HOUSING AND MEMORIAL AFFAIRS

COMMITTEE ON VETERANS' AFFAIRS

HOUSE OF REPRESENTATIVES

APRIL 18, 1989

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to appear before this Subcommittee today and present the views of the Department of Veterans Affairs (VA) on H.R. 1415, the "Veterans' Home Loan Mortgage Indemnity Act of 1989."

VA is well aware, as your invitation letter stated, that in recent years the costs to the taxpayers of operating the Loan Guaranty Program have been significant. We share your concern, Mr. Chairman, about the future solvency of this program which provides an important benefit to veterans, but we do not support H.R. 1415 in its present form. As you know, we have only recently received from Peat, Marwick, Main, and Company an actuarial analysis of the home loan program. As we consider the findings of this report, we will be able to assess more accurately the funding needs of this program and recommend any changes that may be needed to make the program solvent. We would be happy to work with the members of the Subcommittee on both H.R. 1415 and the proposals contained in the Peat Marwick study.

We have analyzed in detail the provisions of the bill. I would like to give a brief summary of the provisions and then provide specific comments on several of those provisions. The bill

would establish a new revolving fund known as the Veterans' Administration Mortgage Indemnity Fund, which I will refer to as the "new Fund." The new Fund would pay for all housing loan operations, other than administrative expenses, with respect to loans originally guaranteed or insured on or after October 1, 1989.

The existing Loan Guaranty Revolving Fund, which I will refer to as the "Revolving Fund," would continue to cover expenses related to loans made prior to that date.

Revenues from the loan fee collected under 38 U.S.C. § 1829 on new loans would be deposited into the new Fund. In addition, there would be credited to the new Fund an amount equal to 1/4 of 1 percent of the original loan amount of each loan guaranteed after the effective date of the bill for which a veteran pays the fee. This credit would be made each year for 3 fiscal years beginning in the year a loan was guaranteed. Apparently, no Government contribution would be made for loans to disabled veterans and surviving spouses who are exempt from paying the fee.

Any amounts collected by VA with respect to such new loans; e.g., the proceeds from the sale of the property, following foreclosure, would also be deposited in the new Fund.

The Secretary of the Treasury would be required to invest the balance of the new Fund not required to meet current expenses in interest bearing obligations of or guaranteed by the United States. Interest earned on such funds would also be deposited into the new Fund.

Collections relating to loans made prior to the effective date of the bill and fees from section 1814 assumptions of such

loans would continue to be deposited into the existing Revolving Fund.

The bill, Mr. Chairman, would also make several amendments to the loan fee paid by veterans. The bill would generally increase the fee from the present 1 percent to 1.25 percent of the loan amount for a veteran obtaining a guaranteed loan after the effective date. If, however, the veteran obtains a loan to purchase or construct a dwelling and makes a 5 percent down payment, the fee would be decreased to 3/4 of 1 percent of the loan amount.

The fee for vendee loans would remain at 1 percent, and the fee from persons assuming existing loans pursuant to section 1814 of title 38 would remain at 1/2 of 1 percent. This amendment would remove the sunset for the fee on new guaranteed loans, but would retain the September 30, 1989, sunset for the fee on vendee loans and section 1814 loan assumptions.

The bill would commit the Government to a 3/4-point subsidy of each new loan to which it applies.

Under current law, all veterans eligible for compensation for service-connected disabilities are exempt from paying the fee. The bill would limit this exemption to veterans whose disability is rated 30 percent or greater.

The exemption from the loan fee given to surviving spouses under the present law would remain unchanged.

The bill would also provide that veterans paying the fee, or those who are exempt from the fee by law, on guaranteed loans, after the effective date would not have any liability to the Government for a loss following default and foreclosure of the loan.

Section 3 of H.R. 1415 would permit VA to sell vendee loans either with or without recourse, but only if the amount received at the time of sale is equal to at least 90 percent of the unpaid balance on the loans.

Section 4 of H.R. 1415 revises the computation of available entitlement after prior use of the Loan Guaranty benefit. As drafted, this section would effectively eliminate the requirement that for restoration of entitlement the property securing a VA loan be disposed of by the veteran. Only the requirement that the loan be paid in full (or assumed by a veteran transferee) would remain.

Section 5 of H.R. 1415 would revise the provisions of section 3102 of title 38, United States Code, relating to waiver of indebtedness to VA. First, the bill would delete "misrepresentation, material fault, or lack of good faith" on the part of the person requesting waivers as statutory bars to such waiver. This amendment would apply to all debts to VA, not just debts arising from the housing loan programs.

In addition, the bill would provide that in considering waiver of a debt established against a veteran as the result of foreclosure of a VA guaranteed loan, VA could not consider solely a balancing of fault or the future ability of the veteran to repay the debt. Currently, section 3102(b) of title 38 permits waiver if "collection . . . would be against equity and good conscience."

We believe that certain provisions of H.R. 1415 would not improve the operation or solvency of the home loan program. These include: the concept of no future liability for veterans who pay the new fee, the 90 percent of par minimum for loan

sales, the use of permanent budget authority to pay a Government contribution and the assumption that it would be sufficient to preserve the liquidity of the fund, and the ability of the existing Revolving Fund to pay the costs associated with loans already guaranteed.

The release of liability under section 2(c) of the bill apparently was not intended to apply to vendee loans or loans assumed under 38 U.S.C. § 1814. We are not certain of the intended effect of the bill's reference to section 1814 assumptions. Under that section of title 38, an eligible transferee merely assumes the veteran's liabilities. Since under H.R. 1415 the veteran would have no underlying liability to the Government, there would appear to be no such liability for a transferee to assume.

We have long believed that veterans, like all Federal borrowers, should be responsible for the debt created through foreclosure and that an "up front" release from liability may increase defaults. However, we also recognize that many times the foreclosure was due to conditions beyond the control of the veteran and it will be difficult, if not impossible, for any repayment of a debt. In those cases, the Secretary is able to consider a waiver of the debt. The authority to waive debts should be used only in appropriate cases, such as when there is little or no likelihood that any debt established against a veteran would be collectable, and when that veteran has responded to VA outreach efforts and has cooperated fully with Loan Guaranty personnel in exploring all alternatives to foreclosure, when the default was not willful, and there were no alternatives to foreclosure. We believe that the authority to establish liability should remain in cases of fraud, material fault, misrepresentation or bad faith on the part of

the veteran and when there is a reasonable likelihood that the debt will be repaid.

Therefore, we oppose section 2 of the bill.

We propose as an alternative to section 3 of H.R. 1415, which would permit the sale of vendee loans with recourse if the amount received at sale equals at least 90 percent of the unpaid balance of the loans, that the Subcommittee consider the proposal that we recently transmitted to the Speaker of the House. That proposal would provide the Secretary flexibility to sell loans in a cost-effective manner, either with or without recourse. For all practical purposes, by requiring that loans be sold for immediate cash proceeds of at least 90 percent of par, H.R. 1415 would prohibit loans from being sold without recourse. On February 9, 1989, we appeared before this Subcommittee, Mr. Chairman, and testified concerning sales of vendee loans. As our testimony more fully explained, selling with recourse incurs a contingent liability to the Government, runs counter to effective debt management and does not provide an accurate measurement of the subsidy inherent in Federal credit. As the results from sales already held by VA demonstrate, selling without recourse is a viable option. The amount of up front proceeds, although an important consideration, is not the only measure of nonrecourse sales. VA will save $56 million in FY 1990 by not having to repurchase loans that subsequently go bad after a recourse sale. Also, by retaining junior securities--which now value $291 million--VA holds a considerable asset that produces over $1 million a month in collections to the Fund and will be sold at a later date, thereby increasing the amount of proceeds scored for each sale.



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Concerning the new permanent budget authority created in H.R. 1415 by requiring a Government matching contribution to the new Fund, we believe this concept should be considered in the larger scope of the Administration's credit reform proposal which would provide appropriations for subsidy amounts without limiting VA's ability to guarantee loans.

Since, Mr. Chairman, H.R. 1415 does not specify a funding source for this Government contribution, it would appear to create permanent budget authority; i.e., a permanent mandatory stream of Federal obligations not subject to the annual appropriations process. In the alternative, the requirement for a Government contribution may establish a loan guaranty ceiling. In the absence of sufficient appropriations, VA may be unable to guarantee new loans unless sufficient funds were available to make the current year's contribution.

We also believe that, if this bill creates a new permanent budget authority, it may run counter to Public Law 93-344, the Budget and Impoundment Control Act of 1974, which requires that new spending authority be effective only to the extent that such amounts are provided in appropriation Acts.

I will next comment on the provision in the bill for revising the computation of available entitlement after prior use of the loan guaranty benefit. From informal discussions with your staff, we understand that the change is intended to assist veterans who do not currently have a VA loan to obtain interest rate reduction refinancing loans. You desire to help veterans who have purchased homes with a VA loan, refinanced it with an FHA or conventional loan, and now wish to refinance again with a VA loan at a lower interest rate. Under current law, these veterans could not have their previously used entitlement restored since they still own the home that secured the

original VA loan. Therefore, most such veterans could not now obtain a VA loan in order to reduce their interest rate.

We would have no objection to this provision if it were limited to interest rate reduction refinancing cases.

The last provision that I will comment on is that contained in section 5 which changes the criteria for waiver of indebtedness. It is our impression that the purpose of section 5 is to liberalize the criteria. Our position, as I stated when discussing release of liability, is that veterans and all other Federal borrowers should be responsible for repaying their debts to the Government, but we do recognize that there are valid reasons for waiving debts.

VA does not believe that misrepresentation, material fault, or lack of good faith should be eliminated as bars to waiver. If this language is eliminated, waiver decisions would be based entirely on the debtor's ability to repay the debt absent a finding of fraud. Since the debtor has a legal obligation to repay the debt to the Government, the role that the debtor played in the creation of the debt must also be fully considered before waiver can be granted. We do not believe that fraud, which involves a willful intent to deceive, is the only basis for denying a waiver. In applying the waiver standard contained in the law; i.e., "equity and good conscience," we believe material fault, misrepresentation, or lack of good faith on the debtor's part are valid considerations, even absent a clearly provable willful intent to defraud. Therefore, we oppose changing current law to liberalize waivers.

Our concern for the future solvency of the Loan Guaranty program has led us to contract with Peat, Marwick, Main, and

Company to conduct a feasibility study of various mortgage insurance options as a cost-effective means of providing the veterans' housing benefit. Various options have been developed, and the contractor has constructed an econometric model to estimate the costs and actuarial implications of various income and cost features.

The model designed by Peat Marwick has utilized as a starting point a computerized forecasting model prepared for us by Booz Allen Hamilton. That model, recently completed, is designed to help develop budget estimates and projections for the Loan Guaranty program.

As part of our contract with Peat Marwick, we have also tasked them to conduct an economic and actuarial analysis of the provisions of the proposed Veterans' Home Loan Mortgage Indemnity Act. We have received the final report from Peat Marwick. It contains this analysis, as well as an analysis of a hypothetical veterans' mortgage insurance program. The analysis on the Mortgage Indemnity Act indicates that the Mortgage Indemnity Fund would incur a $160.3 million shortfall in the fourth year (FY 1993). In the fifth year (FY 1994), the insurance fund would begin showing a deficit which would continue indefinitely. The Mortgage Indemnity Fund, as structured in H.R. 1415, according to the Peat Marwick Study, does not generate sufficient revenue through fees and Government contributions to establish an actuarially sound veterans' mortgage insurance program. Investment income is a major source of revenue for insurance programs. However, under H.R. 1415, a substantial reserve from which to make investments never accumulates. Therefore, investment income cannot contribute toward long-term solvency.

In addition, the VA estimates that under proposed law the Loan Guaranty Revolving Fund would require a total of approximately $3 billion in appropriations for FY 1990 through FY 1994 to meet the ongoing expenses associated with the four million GI loans currently outstanding. The loss of new funding fee income contributes to shortfall in the Loan Guaranty Revolving Fund. These estimates assume continuation of nonrecourse vendee loan sales.

The hypothetical veterans' mortgage insurance program analyzed by Peat Marwick contains the following characteristics of the present Loan Guaranty program:

- zero down payment
- assumability with VA approval
- financed fees
- default assistance offered by VA
- income from sale of REO.

Potential new funding sources of the hypothetical program would include:

- increased up front funding fee
- sliding scale interest rate surcharge keyed to down payment
- investment income from available funds
- a "cafeteria plan" wherein veterans could choose to purchase any or all of the following options:

    - additional entitlement
    - liability insurance
    - free assumability
    - no-bid insurance for lenders.

We recently provided the Subcommittee with a copy of the Peat Marwick study. We are in the process of making a detailed analysis of their findings. After we have completed our analysis, we should be in a position to more accurately assess the program's future funding needs and determine what, if any, changes are necessary to address those needs.

In summary Mr. Chairman, as I have stated, we share your concerns about the Loan Guaranty program. We appreciate the Subcommittee's efforts to address the concerns through H.R. 1415. There are provisions, for the reasons I have given today, that we do not support, because they would not improve the effectiveness of the program and other provisions that require study. We need additional time to determine how to best work out the shared risk between the veteran and the VA. As I have indicated, we would be happy to work with the members of the Subcommittee on both H.R. 1415 and the proposals contained in the Peat Marwick study.

This concludes my statement, Mr. Chairman. I will be pleased to respond to any questions you or the members of the Subcommittee may have.

STATEMENT OF CONGRESSWOMAN MARCY KAPTUR BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

APRIL 18, 1989

HEARING ON MORTGAGE INDEMNITY PROPOSAL

Mr. Chairman, Members of the Subcommittee,

It is a true pleasure for me to appear before you today in strong support of the Veterans' Home Loan Mortgage Indemnity Act of 1989. In the last Congress, this measure was endorsed by the major veterans' organizations and passed the House of Representatives without dissent. Regrettably, the Senate had no time to consider the bill before the 100th Congress adjourned. I applaud your leadership, Mr. Chairman, in seeing that fast action is taken to ensure the long-term restructuring, survival and stability of the Veterans' Home Loan Program. This program has made possible the American Dream for over 13 million veterans and their families and is a pillar of this nation's homeownership commitment.

This legislation will not only strengthen the financial condition of the VA home loan guarantee revolving fund but it will strengthen the position of the veteran homeowner as well. The new indemnification fee, government contributions and investment provisions will achieve savings to the government in the hundreds of millions of dollars. For example, last year, CBO estimated that this bill would save the federal government $118 million in 1991, $410 million in 1992 and $638 million in 1993. Moreover, these reforms will provide an ongoing source of revenues to keep the program serving veterans for many years to come. By eliminating the 1 percent funding fee and replacing it with a new 1 and 1/4 risk-against-loss premium, this will in effect give veterans peace of mind that, in the tragic event that their loan goes into foreclosure, they will not be pursued by the VA for the guarantee amount. Let me point out that FHA, because of its similarly structured program, rarely pursues individuals whose homes have been foreclosed. Nor do most mortgage bankers bother with deficiency judgments against homeowners whose conventional mortgages are under foreclosure. Veterans should not be treated more harshly than other homebuyers. Losing one's home and credit rating is devastating enough and provides sufficient incentive to most homeowners to avoid default.

I am particularly pleased to see the downpayment savings incentives for veterans you have included in the measure. At a time when the savings rate in the U. S. is at a shameful level compared to many of our global economic competitors, it is imperative to encourage Americans to save and invest their money in America whenever possible.

Mr. Chairman and members of the subcommittee, I thank you for giving me this opportunity to speak on behalf of this legislation and complement you for moving quickly to improve the financial stability of the VA Home Loan Guarantee Program. I also want to commend the subcommittee staff for all of the hard work over several years they have put into this effort. Your commitment to this nation's veterans is evident in your actions here today.

Mr. Chairman, I would also like to briefly inform you of a matter concerning the Department of Veterans Affairs and a provision to help homeless veterans contained in the Veterans' Housing Rehabilitation and Program Improvement Act of 1987. This provision offered VA foreclosed properties at a discount to non-profit organizations and local governments which were then supposed to renovate the properties to provide shelter to homeless veterans. It has come to my attention that the VA is not fully promoting this tool to help homeless veterans and, in fact, many loan guarantee officers in regional VA offices seemed to be unaware of this new program. Since this particular provision expires in 1990, I am concerned that the VA's lack of attention to and support of this homeless veterans' assistance program will provide a self-fulfilling prophecy of inneffectiveness when it is evaluated next year. When your subcommittee holds oversight hearings on Public Law 100-198, I hope that you will inquire into this matter and urge the Department of Veterans' Affairs to implement fully all aspects of that law.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-9000

THE GOVERNMENT NATIONAL
MORTGAGE ASSOCIATION

STATEMENT OF LOUIS C. GASPER

EXECUTIVE VICE PRESIDENT

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS

COMMITTEE ON VETERANS' AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

APRIL 18, 1989

Mister Chairman, and Members of the Subcommittee:

My name is Louis Gasper, and I have been Executive Vice President of the Government National Mortgage Association since February 16, 1985. GNMA appreciates the invitation to present its views on the proposed legislation concerning the future of the VA Home Loan Guaranty program.

GNMA is a government owned corporation located within the Department of Housing and Urban Development. GNMA guarantees the timely payment of principal and interest on privately-issued investment securities that are backed by pools of FHA-insured or VA-guaranteed mortgages. Our principal mission is to support the Government's housing objectives by establishing secondary markets to channel funds from the securities into the mortgage market, thereby increasing the supply of credit available for housing.

Currently, over 95 percent of all FHA and VA mortgages are securitized through GNMA. VA loans comprise nearly one-third of our total business.

Mister Chairman, GNMA, as a guarantor, already shares in the financial risk of its issuers who are lenders in the VA loan program. Therefore, we reiterate our long-standing position that we cannot endorse any change in the VA program that would result in increased risk for the lender, decreased responsibility for the borrower, or a weakening, in any way, of the VA guaranty.

You have requested our comments on H.R. 1415, the

"Veteran's Home Loan Mortgage Indemnity Act of 1989."

Establishment of Special Indemnity Fund and Fee

Under the proposed legislation a new Indemnity Fund would be established in place of the old Revolving Fund after the bill's effective date. All fees from loans guaranteed after that date would be credited to the Indemnity Fund. Veterans would see an increase in the fee paid from 1 percent to 1.25 percent. Veterans who put a minimum downpayment of 5% of the total cost of the loan would pay three-quarters of one percent in loan fees. The bill also advocates keeping the fee payment exemption for disabled veterans receiving compensation and surviving spouses of veterans who died from a service-connected disability. In addition, the Government would be expected to contribute one-quarter of one percent of the total loan amount to the fund for a period of three years.

Currently, GNMA is not in a position to make any recommendations as to the size of the loan fee. Recently we were made aware of the release of a study commissioned by the VA on possible options available to the mortgage guaranty program. Although we are not prepared to comment on the study at this time, we will be happy to submit comments to the Subcommittee once the VA has completed its analysis. GNMA does, however, support the bill's provision for a lower fee for veterans who make a minimum downpayment of at least 5% on their loans. Studies have shown the greater the downpayment committed, the less likely it is that the homeowner will default. In addition, we encourage payment of the fee up front, thus increasing the overall commitment of the borrower to the home.

Exemptions

GNMA fully supports the fee exemption for veterans receiving compensation for disabilities rated at not less than 30 percent, and for surviving spouses of any veteran who died from a

service-connected disability.

Proposed Government Contribution

GNMA notes that the proposed legislation contains no specific authority for the proposed Government contribution of one-quarter of one percent each year for a period of three years. We also question whether the amount contributed, combined with the fee income, would be enough to cover future losses in the loan program. In addition, it is unclear just how the government contribution would be determined and what action would be taken if the amount fell short of the actual demands of the program.

Investment of Excess Funds

GNMA supports the provision requiring investment of indemnity funds not needed to meet current payments in obligations of the United States or in obligations guaranteed as to principal and interest by the United States. In addition, we strongly support the stipulation that requires whatever is earned or accumulated as a result of such investment be credited to the Indemnity Fund.

Status of Revolving Fund

GNMA is concerned about the status of the present Revolving Fund. With the establishment of the new Indemnity Fund, the Revolving Fund would lose the 1% fee that it currently relies on as its primary source of income. Provisions for the 1% fee expire on September 30 of this year, after which time substantial appropriations would be required to meet the Fund's continuing obligations. In concern for the solvency of the Loan Guaranty Program, GNMA urges the Subcommittee to address the current obligations of the Revolving Fund as well as the future obligations under the proposed Indemnity Fund.

Liability

The bill states that veterans paying the indemnity fee, or

those exempt from paying the fee, should be released from liability to the Government if they fail to meet their loan obligations. As GNMA shares in the financial risks of its lenders when a homeowner defaults, we cannot support the release from liability provision of the proposed legislation. As we have previously stated, we find this practice to be a sharp and uncalled for departure from VA, FHA and conventional loan liability practices. Personal liability is a key incentive to maintaining a mortgage obligation. GNMA asks the Subcommittee to reflect on the future implications of a loan policy whereby the borrower knows in advance that he or she is not liable to the VA should he or she default on a loan obligation. GNMA asserts that it is essential that the veteran share the risk, as well as the gain, that is taken by the lender and the Government in guaranteeing a home loan obligation. We recognize that the loss of one's home is a risk in itself, but we also contend that the motivation provided by possible personal liability to the United States for the loan is a significant additional stimulus to those few borrowers who might not otherwise make the extraordinary effort to meet their obligations. The release from liability clause is unfair to those who do maintain their obligations or cooperate with the VA and loan holders in exploring alternatives to foreclosure.

Sale of Vendee Loans

Under the draft legislation, section 3, the sale of vendee loans would be restricted by the clause that states they may be sold "with or without recourse, but only if the amount received at the time of the sale is equal to an amount which is less than 90 percent of the unpaid balance of such loan."

GNMA agrees with the VA in objecting to the added restriction placed on the VA's ability to sell loans without recourse. As proposed, the new restrictions would virtually prohibit loans from being sold without recourse. The result

would be an unfavorable increase in the contingent liability of the Government for the full face value of the loan should they default and have to be repurchased. GNMA concurs with the proposal recently submitted by the VA that provides the option to sell loans in a cost-effective manner, with or without recourse.

Computation of Entitlement Amount

Section 4 of the draft legislation revises the computation of available entitlement after prior use of the loan guaranty benefit. This section proposes eliminating the requirement that a veteran dispose of a property secured by a VA loan before restoration of entitlement can occur. Only the requirement that the loan be paid in full (or assumed by another veteran) would remain.

GNMA has no objections to Section 4 of the bill (Computation of Entitlement Amount) provided it is limited to interest rate reduction refinancing cases.

Before closing, I would like to emphasize the strong commitment of both Secretary Kemp and GNMA to the Administration's goals of homeownership and affordable housing. In order to support those goals we must maintain the soundness of all Government housing programs so as not to put an unwarranted burden on the taxpayer. GNMA would like to commend the VA on its efforts to improve its home loan program over the past several years.

Recently, GNMA has enhanced its own efforts to curtail losses in the GNMA MBS program through improved lender monitoring. Failures of lenders in the Mobile Home program especially, has caused GNMA to take over several Mortgage-Backed Securities portfolios, thereby incurring large losses in the nature of acquired mobile homes. The Mortgage-Backed

Securities Fund is sound, but we feel even greater efforts are needed to alert us to potential warning signs so future losses may be reduced. GNMA has currently contracted with a major accounting firm to help develop procedures for improved monitoring of issuers, servicers and custodian banks. These efforts include further automated review of financial statements, more intensive analysis of an issuer's ability to meet its pass-through obligations, and a clarification of accepted procedures.

This concludes my prepared remarks. GNMA thanks you for your leadership and for the opportunity to testify before the Subcommittee. I will be happy to answer any questions you have now, or for inclusion in the hearing record.

April 18, 1989

TESTIMONY OF

DAVID A. LEEN
BEFORE THE SUBCOMMITTEE ON HOUSING AND
MEMORIAL AFFAIRS OF THE COMMITTEE ON
VETERAN'S AFFAIRS, U.S. HOUSE OF
REPRESENTATIVES

Chairman Staggers and Members of the Committee:

Good morning. My name is David Leen. I am speaking in favor of H.R. 1415, a bill that would establish, by a one and one-quarter percent fee from the purchaser and a one-quarter percent contribution from the government, a loan indemnity fund to replace the inevitable losses associated with foreclosure of VA guaranteed loans and the VA's futile and costly efforts to collect home loan deficiencies. Thank you for your invitation to speak on an important issue that affects the lives and well being of hundreds of thousands of veterans in this country. I appreciate the opportunity to support this legislation by relating to our elected representatives the tragic experiences of a number of veterans who have lost their homes and are currently facing deficiency collection by the VA.

I am an attorney in private practice in Seattle, Washington, and member of Vietnam Veterans of America. I have had 18 years of experience in the housing law area, beginning with six years working for Legal Services programs and then specializing in foreclosure defense work in private practice. I am also the Vice Chair of the American Bar Association subcommittee of Veterans Benefits of the Administrative Law Committee. My remarks here today, however, express my personal views only and I am here at my own expense.

I am presently assisting approximately 50,000 veterans in seven (7) states[1] who are pursuing class actions in federal court

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[1]Washington State, Whitehead v. Turnage, No. C87-779WD; Oregon, Connelly v. Turnage, No. CV88-0867RE; California, Jones v. Turnage, No. C-87-4702JPV; Alaska, United States v. Britten v. Turnage, No. C88-142WD; Idaho, Carter v. Turnage, No. 88-1426; Montana, Murphy v. Turnage, No. CV01-89-M-CCL; Arizona, Shepard v. Turnage, No. 88-1236-PHX-EHC. Although the VA relies exclusively on state law to foreclose on a loan in default, it

to force the Department of Veterans Affairs to comply with various state law protections designed to assist those losing their homes in foreclosure. The bill will not, assuming it applies prospectively, provide any of my clients with any protection, but their problems are the problems that this legislation seeks to alleviate.

Currently, the Department of Veterans Affairs (hereinafter the "VA") is seeking to collect about two billion dollars from veterans who have already lost their homes in the foreclosure process. The VA has been transformed into the world's largest collection agency with fewer and fewer resources being devoted to helping veterans obtain and keep housing.[2]

The reasons for foreclosure vary, but there are many common themes: divorce, loss of employment, disability, military transfer or other personal tragedy. The huge indebtedness that results exists because many loans that have defaulted were loans made during the early 1980's when interest rates were 13 to 16 percent and real estate appreciation was flat or declining.[3] Areas of this country, such as Alaska and Texas, have had economic depressions resulting in dramatic unemployment and declining values in real estate which have generated tremendous numbers of foreclosures and huge deficiencies. Inflated appraisals have resulted in negative equity in properties, leaving the veteran with no way to sell (or even give away) the property. In many cases when there was equity, and prior to recent federal legislation to correct the problem, veterans sold the property on an "assumption" and did not obtain a release. Perhaps the third or fourth owner would default with

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maintains that it is free to not follow those portions of state foreclosure law that restrict its ability to recover any loses it pays to lenders. These cases seek to assure that the VA complies with state law.

[2]The VA, according to its own statistics, collects about two percent (2%) of this sum each year and not more than 14 percent of the total debt. Most of the funds collected are by set-off from disability and VA entitlements. 38 U.S.C. 3114.

[3]In 1987 alone, 43,000 veterans lost VA guaranteed homes to foreclosure.

no notice to the veteran. Veterans were particularly vulnerable to "equity skimming".

In these instances, veterans are unable to avoid foreclosure and deficiency claims, despite sincere efforts to meet their obligations. Many lenders are unfamiliar with the VA loan servicing guidelines that allow some leniency prior to foreclosure and unwilling to expend the effort to follow them.[4] But when the home is worth less than the outstanding debt, there is little recourse except foreclosure.[5]

At this stage, many veterans recognize that they can not sell the property to cover debt and seek to deed the property back ("deed in lieu of foreclosure") to the lender. This recourse has been, until recently, routinely rejected by the VA.[6] There being no other option, the foreclosure occurs, resulting in many instances in a loss to the lender of up to $27,500, the maximum VA loan guaranty amount until the recent increase.

After foreclosure, the VA musters its bureaucracy to attempt to collect the "deficiency" from veterans. The methods used include the following:

1. Assessing the amount of deficiency, often without a hearing, where state law allows non-judicial foreclosure;

2. Suing the veterans in federal court;

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[4]The VA can require lenders to take numerous alternatives before foreclosure is commenced, such as recasting the loan, accepting part payments or granting other forbearance. 38 C.F.R. 36.4300 et seq. These regulations are infrequently enforced, but would save vast sums for the taxpayer and allow veterans to keep their homes when temporary financial problems cause delinquency. The courts are reluctant to direct the VA to enforce its own regulations. See, Rank v. Nimmo, 677 F.2d 692 (9th Cir. 1982); Gatter v. Nimmo, 672 F.2d 343 (3rd Cir. 1982); Simpson v. Cleland, 640 F.2d 1354 (D.C. Cir. 1981).

[5]An excellent article that chronicles the plight of veterans who have lost their homes and are facing deficiency claims is found in K. Franklin, "When a House is not a Home", The Veteran, (Nov/Dec 1988) p.11 ff.

[6]Recent legislation has allowed the VA greater flexibility in considering this alternative. it is a valuable tool to cut losses of both the government and the borrower. The Va's ability to "refund" the loan also could be used more effectively.

3. Notifying (and, more often, threatening to notify) credit reporting agencies of the debt;

4. Recouping the claim by set-off from VA disability benefits (and other benefits such as GI Bill, military salary, retirement, widows' pensions, etc.);

5. Attempting collection without notifying the veteran of the foreclosure, after the veteran has sold the property, in violation of the VA's own policy (DVB Circular 20-86-14);[7]

6. By telling veterans (falsely) that the deficiency cannot be discharged in bankruptcy;

7. Denying future VA benefits to those veterans who are indebted to the VA;

8. Intercepting IRS refunds;

9. Seeking to collect "deficiencies" long after the six-year federal statute of limitations has expired;[8]

10. Telling the veteran that they cannot pay more than $10 to an attorney to defend them; and

11. Ignoring state foreclosure law protections that are designed to help the defaulting purchaser.[9]

12. Collection by other coercive tactics that would make a seasoned bill collector blush;

The VA administrators will tell you they are lenient and compassionate when the veteran has a hardship. They are referring to the procedure allowing the veteran to "waive" the indebtedness.[10] To qualify, the veteran must satisfy two stringent requirements. First, the veteran cannot be "materially at fault"

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[7]See U.S. v. Whitney, 602 F.Supp. 722 (W.D.N.Y. 1985)

[8]28 U.S.C. 2415-2416; U.S. v. Allessi, 599 F.2d 513 (2nd Cir. 1979).

[9]Because of the litigation described in footnote 1, the VA may have to refund to veterans sums wrongfully collected over the past six years for failure to comply with state foreclosure laws and the 1979 ruling of the United States Supreme Court in United States v. Kimbell Foods, 440 U.S. 715 (1979). See also, United States v. Vallejo, 660, F.Supp. 535 (1987).

[10]38 U.S.C. 3102; 38 C.F.R. 1.963(a).

in creating the debt. This occurs when the hapless veteran sells the property to a person who later defaults. Second, the veteran must also be unable to reduce the indebtedness because the veteran is destitute, completely disabled, or otherwise unable to reduce the indebtedness.

The VA typically rejects about 98 percent of all requests for waiver of indebtedness. This, however, may be a blessing in disguise.

The worst thing that can happen to a destitute veteran not materially at fault in creating the indebtedness is for a waiver to be granted. When a waiver is granted, the VA does waive the debt, but then the VA contacts the IRS, notifying them by form 1099 that the "forgiveness of indebtedness" constitutes taxable income. This action results in an assessment of tax liability for the full amount of the debt, transforming a debt that was dischargeable in bankruptcy to a non-dischargeable tax liability of approximately 25 percent of the original debt. The destitute veteran (who, by definition, must be unable to pay anything to reduce the debt) loses again, and faces criminal penalties for not paying taxes owed.

The VA has, in a figurative sense, the choice in many of these situations of accepting $500 in cash or a $1,000 "bad check". It chooses the later in 99 percent of the cases.

Here are some examples[11] of veterans from whom the VA has sought collection.

1. Carol Underwood. Carol is a 53 year old widow of a veteran who died in 1973. In 1984, she was diagnosed with cancer and was unable to work because of the medical treatments. Her home was foreclosed in 1985. Her request for waiver of the $15,000 claim was denied because the VA believed she could repay a significant portion of the indebtedness before she died. There-

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[11] These examples are from sworn affidavits filed in Whitehead v. Turnage, 701 F.Supp. 795 (1988).

after, the VA intercepted her pension without a hearing. She filed bankruptcy, pro se in July, 1985, because she could not afford counsel, listing as her only debt the VA claim. She then read a newspaper article about the Vallejo case[12] and joined a class action successfully challenging the collection of deficiencies in Washington where the non-judicial procedure was used, and abandoned the bankruptcy.

2. Gregory Smith. Greg obtained a VA guaranteed home loan in 1981 (at 15.5 percent APR) which went into default when he lost his job. He offered the lender and the VA a deed in lieu of foreclosure, which was summarily rejected and the foreclosure occurred. The VA seeks $27,500 from him, despite the fact he has never been afforded a hearing on this debt.

3. Harold Whitehead. Harold was a Korean War Air Force veteran. He had a heart attack and was discharged at 100 percent disability. However, this was later reduced, without any reason being given, to 30 percent disability. Because of his medical condition, he could not afford to make his home loan payments. Before the loan went into default, he sold the house to an "equity skimmer" who never made a payment. The VA came back to Harold with a claim for $8,000. His request for waiver was denied and his disability check taken without a hearing.

4. Robert Dohlke. Robert was a career military veteran whose property was part of a boundary dispute during the county's boundary reorganization. He sold the property and the purchaser failed to make payments. The property was subsequently foreclosed, but Robert was not notified. The VA claimed $25,000 from him and withheld his disability pension without a hearing. He now cannot obtain credit or improve his housing because of his negative credit

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[12] In United States v. Vallejo, 660 F.Supp. 535 (1987), the United States District Court for the Western District of Washington declared that the VA must comply with State foreclosure laws. The VA did not appeal this ruling, but did not follow it. Thereafter, the Whitehead class action was commenced. See footnote 1, supra.

record.

5. David Casey. David purchased a home in Spokane, Washington and subsequently defaulted when his employment was reduced and he was injured in an auto accident caused by an uninsured driver. The VA assessed $8,500 against him and withheld his disability check without any hearing.

6. Louis Banks. Louis was a career military veteran who purchased a home in 1982. In 1984 he defaulted because he had a heart attack and couldn't work. He made the payments one month late, but this was not acceptable to the lender. The VA refused his offer to make one and one-half monthly payments, so he was forced into default. Thereafter, he was evicted and, with his family, moved into a 28' trailer with no running water. He then had another heart attack. The VA took his entire disability check, until the court determined that the deficiency claim was invalid.

7. Roy Miller. Roy was in the Air Force between 1970 and 1984. He purchased a home while in the Air Force, but defaulted after he and his wife divorced. His requested waiver was denied and his entire disability check was thereafter withheld without a hearing. He is unable to obtain employment and the disability check was the only source of funds available to support him and his daughter. The VA took over $5,000 from his disability until stopped by court order.

8. Steve Duncan. Steve suffered service connected injuries in Vietnam and never fully recovered. He was discharged with disability. After his second divorce, his ex-wife defaulted on the home that was awarded to her. Thereafter, the VA withheld his disability check while Steve was forced to live in his car. Steve paid the debt from his disability in full at great hardship. He continues to be disabled. A federal judge has ordered the VA to refund the disability benefits taken from him, but the VA has refused to comply and has appealed the ruling.

The list is endless. These examples, from sworn affidavits

filed in the Whitehead v. Turnage case, are typical of the plight of thousands and thousands of veterans who have lost their homes.

H.R. 1415 would recognize the obvious: The VA cannot efficiently collect deficiencies following foreclosures because the borrowers are financially unable to meet their financial obligations.[13] The General Accounting Office has recently criticized the VA for wasting incredible amounts of tax dollars to collect the uncollectible.[14] The hardship imposed by the VA on veterans results in deprivation for the veterans and his/her family, bankruptcy and a demoralized view of the government that induced the veterans to serve our country. Bankruptcies that are generated by VA collection attempts also discharge large amounts of private sector debt which negatively impacts our economy in immeasurable ways.[15] The VA is forcing veterans and their families onto the state welfare rolls, thus costing the tax payers even greater sums.

Our government should create the promised "kinder and gentler society", recognizing that a small number of foreclosures are inevitable and that the cost should be shared by the initial loan fees and a small subsidy.[16] This is greatly preferable to the continued expansion of the world's largest collection agency that hounds our country's heros onto welfare and into degradation.

The pending legislation should insure that:

1. Lenders do not seek to collect deficiencies at the direction of the VA to circumvent this legislation.

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[13]FHA, by contrast, has recently considered and rejected the VA approach to collection of deficiencies and only seeks collection when circumstances warrant and there is a realistic prospect for recovery. It would not be unreasonable to allow the VA to continue to collect deficiencies when fraud or waste is committed and there appears to be a reasonable prospect of recovery.

[14]See Franklin, supra, p.12; the GAO report has not been released yet to the public.

[15]Almost $200 million of VA deficiency debt is discharged in bankruptcy each year.

[16]About one loan in four hundred results in foreclosure. This would create, under the proposed legislation, a fund of $399,000 for each foreclosure. Insurance companies would envy this actuarial basis.

2. Appraisals currently reflect the value of the home when purchased.

3. Servicing guidelines are followed to seek to avoid foreclosure or accept deeds in lieu where beneficial. Veterans want to meet their obligations.

4. That the intent of this legislation be applied to those two hundred thousand veterans who now owe the VA a total of $2 billion and who are unable to pay because of their tragic circumstances. They should not be denied disability and be forced to live in cars or on the streets. They deserve better treatment for their dedication to their country demonstrated during their military careers.

5. The VA complies with applicable state laws in the foreclosure process that allow redemption and reinstatement.

I thank the Chair of this committee and its members and staff for thoughtful consideration of this important issue. Surely the plight of veterans who have lost their homes can be ameliorated by the sharing of the inevitable, and, relatively minor, cost of foreclosure, rather than spending the taxpayer's dollars to chase the veteran's nickels.

STATEMENT OF

JERRY MCGUIRE

FOR THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

HOUSE VETERANS AFFAIRS SUBCOMMITTEE ON HOUSING & MEMORIAL AFFAIRS

APRIL 18, 1989

Introduction

Mr. Chairman, members of the Subcommittee, my name is Jerry McGuire. I am a REALTOR® from Denver, Colorado. On behalf of the more than 800,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I would like to thank you and the Subcommittee for your continuing commitment to promoting and maintaining homeownership opportunities for our nation's veterans. We appreciate this opportunity to testify with regard to H.R.1415, the "Veterans Home Loan Mortgage Indemnity Act of 1989".

We strongly support the VA Home Loan Guaranty Program which, over the last forty-five years, has enabled more than 12 million American veterans to purchase and maintain their homes. We believe the continued success of this program depends largely on the implementation of measures to ensure its financial viability. Consequently, this goal of financial viability should be the key premise guiding the Subcommittee's deliberations as well as the result of any alterations that the Subcommittee deems necessary to make to the program. As you know, last year the NATIONAL ASSOCIATION OF REALTORS® testified before this Subcommittee in opposition to the Indemnity Bill. We understand and appreciate, however, that you have introduced this bill as a framework from which discussion will build. Since we testified last June, we have spent much time formally deliberating this issue amongst our membership. Although the NATIONAL ASSOCIATION OF REALTORS® has modified its formal policy position somewhat as a result of these deliberations, we continue to have certain concerns about the bill.

Specifically, our concerns with the "indemnity fund proposal" include:

Role of Indemnity - The NATIONAL ASSOCIATION OF REALTORS® continues to question the appropriateness of providing blanket indemnity to a veteran upon the purchase of his or her home. It is our belief that veterans--indeed all homeowners--should, in the face of default and foreclosure, be provided every possible opportunity to maintain their home. Aside from homeownership being the central component of the American Dream, a key motivation for a homebuyer to maintain his or her home purchase is the degree of personal liability for the loan.

Thus, the concept of blanket indemnity (i.e., the removal of any and all liability) for a mortgage loan could potentially become a greater risk to the VA Home Loan Guaranty Program because it could result in veterans becoming more willing to default on their mortgage. Legislation which completely releases veteran-borrowers from all liability could have detrimental consequences in areas which experience substantial drops in real estate values, since there would be little incentive for homeowners to continue to maintain their obligations to pay for homes which are valued at considerably less than the mortgage debt. This would increase foreclosures in such areas.

In addition, there are situations in which it is appropriate to require borrowers to be responsible for deficiencies after foreclosure. Such situations involve cases where the borrower participated in fraud or misrepresentation in obtaining the loan, where the borrower willfully defaulted on the loan or where the borrower refused to cooperate with the Department of Veterans Affairs by taking action which would reduce the Government's loss due to the default.

The Association can not condone the concept of complete and blanket indemnity; however, we are aware that there are certain specific cases (i.e., loss of job or depression of the local economy) where indemnification may be appropriate. There are many cases in which the loss of a home and the related loss to the Government are outside the veteran's control. Accordingly, the NATIONAL ASSOCIATION OF REALTORS® believes indemnity should be allowed by the Department of Veterans Affairs on a case-by-case basis. Giving the Department of Veterans Affairs this option would enable it to release or retain collection rights as appropriate depending on the facts in each case.

Increase of Funding Fee - The NATIONAL ASSOCIATION OF REALTORS® opposes the proposed increase in the amount of the up-front fees that a veteran will be required to pay to obtain a VA-guaranteed mortgage. The proposed indemnity fee--1.25 percent of the loan amount--represents a slight, but important increase over the current one percent "funding fee". Further, this legislation would make the fee permanent. Increasing the fee on loans would raise up-front costs for veterans and represent a tax on veteran homebuyers. The NATIONAL ASSOCIATION OF REALTORS® has always believed the Department of Veterans Affairs Home Loan Guaranty Program is an entitlement program. This proposed increase in the fee is of great concern to our Association. Proposals that continue to recommend a fee increase violate the spirit of the Home Loan Guaranty Program which was enacted by Congress as an entitlement program.

We recognize that supporters of this legislation contend the entitlement nature of the program is maintained in that the proposed increase in the up-front fee is more than offset by complete indemnification upon default. While there may be some merit in this argument, it disregards an even more fundamental problem--the initial ability of veterans to pay the proposed 25 basis point increase at all. Given the ever-increasing housing affordability crisis of higher housing prices and interest rates, 25 basis points could mean the difference between a veteran owning or not owning a home. We believe it is more critical to ensure that the veteran be afforded every opportunity--at the outset --to purchase a home. Unilateral protection of the veteran once he or she has already purchased a home does not vitiate or otherwise diminish the initial hurdle. Consequently, we cannot support the proposed increase in the upfront funding fee.

Sale of Vendee Loans - The proposed bill would authorize the Veterans Administration to sell vendee loans, with or without recourse, provided that the purchase price is at least 90% of the unpaid loan balance. The NATIONAL ASSOCIATION OF REALTORS® has long sought to ensure that the sale of VA vendee loans does not result in the "dumping" of valuable VA assets. Thus, the NATIONAL ASSOCIATION OF REALTORS® is pleased to support the proposed bill's establishment of a meaningful minimum threshold for the sale of Department of Veterans Affairs vendee loans with or without recourse and we applaud the Subcommittee in developing this proposal.

Use of Funds - We understand that, under the proposal, the VA would be authorized to invest portions of its stockpiled funds in order to increase earnings. We are in agreement that any portion of the indemnity fund that is not required to meet current payments should be invested in obligations guaranteed by the United States government because the additional monies will increase the fund's financial viability. If this approach is adopted, then the legislation should clearly stipulate that whether earned or accumulated under the proposed indemnity program, all funds should be used solely to cover the costs and obligation of the VA Mortgage Indemnity Program.

Further, we cannot help but be concerned over the recently released Peat Marwick Analysis of the Mortgage Indemnification Fund Balance. This analysis of Peat Marwick indicated the indemnity fund will diminish to a deficit balance by 1993. Investment income provides little benefit under this program since the Fund's balance becomes negative after four years. Since the Peat Marwick study has just been made available, we respectfully request that you allow our Association the opportunity to review the results and conclusions of the study prior to issuing any comments regarding the analysis.

Mr. Chairman, we appreciate the opportunity to testify at these hearings on H.R. 1415, the "Veterans Home Loan Mortgage Indemnity Act of 1989". The NATIONAL ASSOCIATION OF REALTORS® has appointed a task force which will study the Peat Marwick and other proposals which make this an effective program. We are pleased to work with the Subcommittee on this issue. I will be happy to answer any questions.

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Mortgage Bankers Association of America

STATEMENT OF

JAMES A. ABBOTT, CMB
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FIRST UNION MORTGAGE CORPORATION
CHARLOTTE, NORTH CAROLINA

on behalf of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

Hearing on

H.R. 1415

The "Veterans' Home Loan
Mortgage Indemnity Act of 1989"

April 18, 1989

Mr. Chairman and members of the Subcommittee, I am James A. Abbott, CMB, President and Chief Executive Officer of the First Union Mortgage Corporation in Charlotte, North Carolina, and Chairman of the Legislative Committee of the Mortgage Bankers Association of America (MBA).* Accompanying me today are Burton C. Wood, MBA's Legislative Counsel, and Linda K. Bumbalo, MBA's Associate Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify on the Veterans Administration (VA) home loan guaranty program and on HR 1415, the "Veterans' Home Loan Mortgage Indemnity Act of 1989," introduced by you, VA Committee Chairman G. V. ("Sonny") Montgomery (D-MS) and Ranking Minority Member Bob Stump (R-AZ) on March 15, 1989, to create a mortgage indemnity fund for new VA loans and to provide for the sale of vendee loans with or without recourse. MBA would also like to comment on the proposed changes by the Administration to the no-bid formula used to decide whether the VA or the mortgage lender acquires a foreclosed property. MBA continues to be extremely concerned about the long-term solvency of the Loan Guaranty Revolving Fund (Revolving Fund), a problem that is of vital importance to all veterans, as well as to mortgage bankers, who are the largest lender segment involved in making mortgage credit available to the veteran participants in the program.

Before discussing these issues, MBA wishes to express its gratitude to the Committee for its assistance in efforts to implement the interest accrual amendments to the no-bid formula enacted December 1987 in P.L. 100-198, the "Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987". On March 31, the VA published the proposed no-bid regulations, which MBA is reviewing. A comment letter will be submitted to the VA, and at the oversight hearing scheduled for May 11, MBA will offer its comments to this Subcommittee. Disappointingly, the regulations for direct appraisals and underwriting on assumptions have still not been released.

Mr. Chairman, MBA certainly understands the interest in exploring a new financing mechanism for the VA home loan program. Under the current system, the risk burden associated with loan foreclosures is shared by the lender, the veteran, and the Federal government—the veteran by paying the 1 percent funding fee, the lender by the losses sustained on no-bids, and the Federal government by appropriations. Although all of these parties are bearing heavy cost burdens, the program is still in distress.

This Subcommittee is faced with difficult choices if losses are to be reduced on future VA loans. As to the existing VA loans, little choice exists but to share the losses, as is currently occurring with lenders bearing losses as a result of "no-bids" and the government carrying the balance of the burden with substantial appropriations. Lenders today are bearing a sharply higher and unfairly burdensome proportion of all losses on VA loans. The lender's loss on a no-bid case is between $15,000 and $20,000. In 1988, lenders incurred $200 million of losses on no-bids.

## MORTGAGE INDEMNITY ACT OF 1989

HR 1415, the "Veterans' Home Loan Mortgage Indemnity Act of 1989", (Indemnity Act), would create a new financial mechanism as an alternative to the current Revolving Fund for providing monies to operate the VA home loan guaranty program (the program) in the future. The proposal would increase and make permanent the funding fee and would appropriate Federal monies for all VA home loans when they are originated. It leaves in place the no-bid provisions, so lenders will continue to share in the risk burden.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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Funding fee. The Indemnity Act would make permanent the current temporary funding fee paid by veterans for loan originations by lenders and would increase it from 1 percent to 1.25 percent for no-downpayment loans. For loans with at least a 5 percent downpayment, the fee would be .75 percent. The Federal government would pay .25 percent of the loan amount into the Indemnity Fund in each of three consecutive fiscal years, beginning in the year the loan is originated, for a total of .75 percent.

Historically, MBA has called attention to the fact that the fee was not contemplated when the program was instituted, but that a temporary fee may be necessary for the financial stability of the Revolving Fund. In making the decision whether to make the funding fee permanent, Congress should consider whether such action alters the entitlement nature of the program.

The funding fee originally was instituted on January 1, 1983, to alleviate the financial stress on the Revolving Fund. The need for new sources of income for the Revolving Fund was caused by foreclosure losses in economically distressed parts of the country. The termination of the direct loan program on October 1, 1980 added to the Fund's deficiency. Initially established at 0.5 percent, the funding fee was increased to 1 percent in 1984 and was extended in 1987, in PL 100-198, for two years until September 30, 1989. Repeated attempts over the last several years by the Administration to increase this fee have failed.

However, MBA does believe there is merit to the proposal to match on a sliding scale the funding fee with the downpayment. In our testimony before this Subcommittee on June 16, 1988, MBA stated that such a sliding scale preserves the existing benefits offered by the VA loan program with its no downpayment ease of entry into mortgage financing, yet borrowers would bear a burden commensurate with the risk presented by the benefit they would receive. No downpayment loans would carry the maximum applicable funding fee necessary to offset the risk of loss associated with such loans.

Veterans' liabilities. The bill also proposes to release any veteran who pays the permanent fee from liability to the VA, in case of default on the VA loan. There are several issues associated with this proposal. First, MBA would like to point out that one element of the incentive to keep a loan current is the consequence of being responsible for payment of the debt. Congress should make a conscious decision about the effects of a government policy where borrowers know in advance that there is impunity in case of defaults on their loans. One question that needs to be addressed in such a context is what impact a release from liability to the VA for VA loans would have on other government loan programs. Consideration should be given to granting the VA the option of releasing veterans from liability on a case-by-case basis.

Second, the proposed release from all liability would apply only to properties acquired by the VA. In no-bid cases, where the lender acquires the property, the VA would pay the lender only the guaranty claim. In such cases lenders are not indemnified for all of their losses. They still have the legal right to collect from veterans the amount of the debt that remains unsatisfied. Although veterans whose foreclosed properties are acquired by lenders would have paid the same permanent funding fee as defaulting veterans whose properties are acquired by the VA, these veterans would not be released from liability with respect to losses resulting from the loan for which the VA has not reimbursed the lender. The veteran's release from all liability, therefore, is conditional on whether the foreclosure results in the VA acquiring the property. No-bids result in cases of loans with the greatest losses, and it is these veterans who would not be released from all liability. It is the veterans with relatively lower losses who would be relieved from all liability. No-bids occur in almost one out of four foreclosures.

There would be consistency to the insurance-for-veterans nature of the proposal if the VA would acquire the property and pay the full amount of the debt to the lender in every case of foreclosure. Then all veterans would be relieved from all liability. There is no rationale for the no-bid formula if the purpose of the Indemnity Act is to release veterans from liability in exchange for paying a permanent loan fee. By maintaining the no-bid formula, the proposal only grants the veteran a contingent release from liability.

Budget impact. The Indemnity Fund proposal will have several budget impacts. First, it will increase the need for appropriations to the existing Revolving Fund, because the current funding fee revenue to the Revolving Fund would be eliminated, and there would be only minimal income from other activities to offset defaults on existing loans. The VA would be under pressure to increase sales of VA-acquired properties to increase short-term revenues to the Revolving Fund. This policy could result in excessive VA sales in troubled market areas, which could further depress regional market values and reduce long-term revenues to the Fund.

Second, MBA is concerned about estimating loan activity for purposes of appropriating the Federal government's 75 basis point share and about program continuity in the event estimates are too low. MBA is concerned about who would project loan activity and that this projection would become subject to political forces. The Office of Management and Budget could underestimate projected volume in an effort to discourage use of the program. Also, it is not clear what would happen if the projection was too low. MBA hopes that the VA would not be precluded from guaranteeing loans if the Federal share of the VA guaranty premium fell short because a projection was inaccurate. Also, there is no specific authorization for appropriations, and it is unclear how the additional three quarters of a percent three-year fee will be provided. Presumably, there would be some estimate of the total dollar amount of loans originated in a given fiscal year, and an appropriation for that amount would be requested.

The Administration's FY 1990 budget indicated that the Administration planned to submit a legislative proposal to identify the "grant equivalent" subsidy of Federal credit (direct loan, loan guaranty, and insurance) programs. While that legislation has not yet been transmitted to the Congress, the budget indicates that it would quantify a claimed "implicit subsidy" for guaranty programs and require an upfront appropriation of that amount. That "grant equivalent" subsidy was allegedly to recognize the "favorable financial terms" of guaranty programs, compared with the terms under which borrowers obtain loans from private lenders. MBA continues to oppose such credit legislation because it represents the Administration's philosophy of credit subsidy estimates, which attempt to place a value on the Federal guarantee.

In addition, MBA is concerned that the proposal would reverse a provision which the Congress instituted in P.L. 100-198 exempting the VA loan guaranty program from sequestration. Sequestration is the process by which across-the-board spending cuts are instituted if Federal deficit levels exceed targets established by the Gramm-Rudman-Hollings Deficit Reduction Act. Under sequestration, the budget authority provided to the new Indemnity Fund would automatically be reduced, and the number of loans that could be originated would accordingly be reduced. This automatic reduction could occur at a time when the demand for mortgages is very high. Consequently, as in the case where projections were simply inaccurate, veterans fully eligible for the guaranty program and entitled to the guaranty as a benefit would not be able to obtain a VA guaranteed loan. However, here, this could occur because the deficit was too high for reasons completely unassociated with the VA program.

Peat Marwick Study. On March 8, 1989, KPMG Peat Marwick submitted its final report on its findings and conclusions about the VA's loan guaranty program. In that report, it did an analysis of the Mortgage Indemnity Fund legislation (HR 5221) passed by the House of Representatives in 1988. As Peat Marwick explained, the projected foreclosure rate was the most sensitive factor in determining the size of the obligations of the Indemnity Fund. Peat Marwick estimated an ultimate 30-year foreclosure rate of 15 percent; but at the VA's request, it incorporated the VA-derived foreclosure rate of 11 percent into its analysis.

The report finds that the increase of 25 basis point in the funding fee for no downpayment VA loans adds more revenue to the Indemnity Fund than is lost by the 25 basis point fee reduction for 5 percent downpayment loans. In addition, the government funding is considered the most significant factor. Investment income is not considered a powerful source of revenue because the government's 75 basis point share is received pro rata over three years.

The report concludes that the Indemnity Fund would not be solvent after its first four years and that in years five through 35 there would be a deficit balance. Given this result, some modifications to the proposal might result in a reversal of this financial situation. Possible changes could include acceleration of the rate at which the Federal government's 75 basis points are contributed to the Indemnity Fund. In addition, the sliding scale based on the amount of the downpayment used to determine the size of the funding fee paid by the veteran might be adjusted.

## VA PROPOSAL TO INCLUDE COST OF FUNDS IN NO-BID FORMULA

In its proposed Fiscal Year (FY) 1990 budget, the VA reported it would make a change to the no-bid regulations, effective October 1, 1989. The "cost" of government borrowing would be included among the VA's costs to acquire a foreclosed property when calculating

the "net value" of a property. The VA notified the House and Senate VA Committees January 31, as it was required to do, that it intended to implement this no-bid formula change for FY 1990 on October 1, 1989. The Administration's FY 1990 budget estimated that adoption of the cost of funds change would shift an additional 10 percent of the properties the VA acquires to lenders.

Subsequent to this FY 1990 budget proposal, in March, the VA sent to Congress a request for supplemental appropriations for the loan guaranty program for FY 1989. In this request is a statement that the VA intends to begin implementing the cost of funds provision in FY 1989 rather than October 1, 1989. This would increase lenders' no-bid losses by $20 million in August and September of this fiscal year, 1989.

Then, on March 31, the VA published the proposed regulations that would revise the definition of "net value" to take into account the government's cost of borrowing in determining "net value," and on April 5, published the proposed effective date as August 1, 1989.

By taking this action to implement the "net value" definition change on August 1 for FY 1989 rather than on October 1 for FY 1990, the VA has ignored the procedure set forth by Congress in the language of the Conference Report 98-861 accompanying P.L. 98-369, the "Deficit Reduction Act of 1984", which enacted the no-bid formula. In that language the conferees stated:

> "In connection with the VA's calculation of the costs of acquiring and disposing of properties, the conferees do not intend to change the VA's current policy of not considering interest costs that the United States would incur if it were necessary for the government to borrow the funds for a particular acquisition. If the Administrator determines that change of this policy is warranted, notwithstanding the conferees' position as stated above, the Administrator shall, not later than the February 1 preceding the fiscal year in which a proposed changed would take effect, provide the Veterans' Affairs Committees with notice of the change."

The VA apparently has interpreted the report language as non-binding because it has not complied with the procedure for FY 1989. However, the language of the no-bid statute is binding, and the action taken by the VA in the proposed regulations exceeds the authority given to it by the statutory language.

The term in the no-bid formula statute that is affected by the VA proposed regulations is "net value," which the statute defines as "the amount equal to (i) the fair market value of the (real) property, minus (ii) the total of the amounts which the Administrator estimates the Administrator would incur...for property taxes, assessments, liens, property maintenance, property improvements, administration, resale, and other costs resulting from the acquisition and disposition of the property."

In comparing the proposed revised definition of "net value" with the definition of "net value" in the final regulations published on January 19, 1988, MBA notes several changes. In addition to changing the word "Administrator" to "Secretary" (for the new VA Department), the words "costs...incurred by VA..." are changed to "costs...incurred by the Government...". This regulatory change of who is incurring the estimated costs is in direct conflict with the statutory language set forth above. The statute clearly allows to be deducted from fair market value only those amounts which the Administrator (Secretary) would incur, not those amounts which the Government would incur, as the proposed regulation states. Because the Administrator (Secretary) is not charged any interest costs for acquiring a foreclosed property, the cost of government borrowing is not a cost incurred by the Administrator (Secretary) and not permitted under the statute to be included in the definition of "net value".

MBA strongly opposes this change in the no-bid calculation. If Congress does not act to prevent this change in the "net value" definition, irreversible damage will be done to the VA home loan guaranty program. The estimated increase in no-bids would further deter lenders from participation in the VA home loan guaranty program. In a January 1989 national survey done by MBA, almost 70 percent of the lenders surveyed said they would limit their VA-guaranteed loans if VA rules were changed to increase the number of foreclosures where the lender must acquire and dispose of the property.

The number of no-bids has continued to increase unremittingly from 1,496 or 6.4 percent of foreclosures in FY 1984, to 11,391 or 23.9 percent of foreclosures in FY 1988. (See Exhibit I.) Although the interest accrual rules for certain cases of foreclosures delays

that were passed in 1987 to offer lenders some no-bid relief, as previously stated, have been proposed, they have not been implemented by the VA. Lenders have still not experienced the benefits of that law. Including the hypothetical cost of funds in the no-bid formula will add to the lenders' no-bid burden. If the long overdue interest accrual relief is implemented by the VA at the same time as the cost of funds regulation, lenders will not benefit from the no-bid relief that Congress intended them to have.

In the future, lenders will have to limit further their participation in the VA home loan program. Since the no-bid formula was enacted in 1984, VA's market share of fixed rate loan originations has been steadily eroding, while FHA's share has slightly increased. Over the last 5 years, VA's share of the market has dropped from 13.0 percent to 7.9 percent, while FHA's share has risen from 18.0 percent to 19.4 percent (See Exhibit II). This is clear evidence that lenders are reacting to their increased potential liability when deciding whether or not to participate in the VA program.

MBA appreciates the opportunity to submit this statement to the Subcommittee and would be happy to provide additional information, as necessary, for inclusion in the record.

**EXHIBIT I**

**VA NO-BIDS AND FORECLOSED LOANS**

| Fiscal Year Ending | Loans Foreclosed | Number of No-Bids | Number of No-Bids As Percentage of Total Foreclosed |
|---|---|---|---|
| 1981 | 12,490 | 358 | 2.9 |
| 1982 | 15,427 | 238 | 1.5 |
| 1983 | 21,176 | 689 | 3.3 |
| 1984 | 23,377 | 1,496 | 6.4 |
| 1985 | 27,276 | 3,055 | 11.2 |
| 1986 | 34,642 | 5,236 | 15.0 |
| 1987 | 43,316 | 9,097 | 21.0 |
| 1988 | 47,712 | 11,391 | 23.9 |

Source: Veterans Administration
Prepared by the Mortgage Bankers Association of America, February 1989.

**EXHIBIT II**

**MARKET SHARE**

**OF**

**FIXED RATE MORTGAGE ORIGINATIONS**

| YEAR | VA | FHA | CONVENTIONAL |
|---|---|---|---|
| 1984 | 13.0 | 18.0 | 69.0 |
| 1985 | 10.8 | 20.4 | 68.8 |
| 1986 | 9.4 | 18.9 | 71.7 |
| 1987 | 8.2 | 19.1 | 72.7 |
| 1988 | 7.9 | 19.4 | 72.7 |

Compiled by Mortgage Bankers Association of America, March 1989.

**STATEMENT OF**

**THE NATIONAL ASSOCIATION OF HOME BUILDERS**

**before the**

**COMMITTEE ON VETERANS AFFAIRS**

**SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS**

**U.S. HOUSE OF REPRESENTATIVES**

**on the**

**VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT**

**April 18, 1989**

Mr. Chairman and Members of the Subcommittee:

My name is Jim Irvine and I am from Portland, Oregon. I am testifying on behalf of the 155,000 members of the National Association of Home Builders. I have been involved in the VA Home Loan Guaranty Program since 1973 and am Chairman of NAHB's Federal Government Affairs Committee.

Mr. Chairman, we appreciate this opportunity to appear before you to express our views on proposed legislation before the Subcommittee on the VA Home Loan Guaranty Program. In February, our First Vice President testified before the Subcommittee on the Administration's FY '90 budget proposals. We are pleased that subsequent to that hearing the Bush Budget dropped the proposal for an increase in the VA fee to 3.8 percent and the VA Committee rejected the Administration's proposals for a negotiated interest rate and federal credit reform.

Today, you have asked for our views on the Veterans' Home Loan Mortgage Indemnity Act, which passed the House of

Representatives last year (H.R. 5221) and which has been reintroduced (H.R. 1415) this year. Before enacting this legislation, we urge you to analyze again its effects and impact on the VA program.

INTENT OF THE PROGRAM

Mr. Chairman, it is important that the VA Home Loan Guaranty Program be maintained and run in an efficient manner. It is also important, however, that the various benefits of the program be kept when seeking program improvements.

Congress passed the VA Home Loan Guaranty Program in 1944 so that veterans returning from war could have an opportunity to buy a home and achieve the American dream. This program was created as an entitlement for the men and women who fought World War II and was extended to those who served in subsequent times of both war and peace. They were given this benefit because they did not have the opportunity to raise the necessary capital for a downpayment for a home, or to establish a credit rating during their service to our country.

This program has been in existence for forty-five years and changes should not be made without careful consideration as to why the program was passed in the first place, whether it will continue to attract qualified members into the service and whether it will remain as a benefit to those it was meant to serve.

A review of the program must recognize that the nature of an entitlement program is fundamentally different from that of

traditional financing programs and requires a higher level of commitment from Congress. We urge that any changes to the operation of the program in the future be carefully made without jeopardizing the entitlement nature of the VA guaranty.

IMPACT OF THE LOAN GUARANTY REVOLVING FUND

Mr. Chairman, there has been concern that the Loan Guaranty Revolving Fund (LGRF) has required appropriations over the past few years to sustain the viability of the VA Home Loan Program.

From the inception of the program in 1944, until 1961, the VA program was funded through appropriations. It was then that the Loan Guaranty Revolving Fund came into existence to provide funding for the program. Up until the past six years, the program under the LGRF was self-sustaining.

A number of factors can be attributed to the losses the LGRF is now experiencing. First, severe downturns in regional economies since the early 1980's, for example, in the Great Lakes area and in the oil and agriculture dependent states today, have caused high foreclosures and claim rates. This has precipitated drains on the revolving fund which require additional appropriations.

Second, the flow of income to the fund has been altered by Administration policies. The Direct Loan Revolving Fund (DLRF) which supplemented the LGRF was terminated in 1981. It was common practice for transfers to be made from the DLRF to the LGRF when a deficit occurred. Additionally, the Administration

is requiring the VA to sell its vendee loan portfolio, (direct loans made to new buyers to purchase foreclosed homes) which will no longer bring in principal and interest payments, disrupting the income stream formerly realized by the Loan Guaranty Revolving Fund.

It must now be taken into consideration, however, that the economy is turning around in some depressed areas and that future appropriations may not need to be as substantial as those needed in the past few years.

For example, even in Houston Texas, one of the most depressed areas during the recent economic downturn, figures are showing a positive outlook. Building permits, which are an indicator of future housing starts, increased in the Houston area by 24 percent from 1987 to 1988.

Total employment in Houston increased from 1.401 million in December 1987 to 1.448 million in December 1988. This is a 3.3 percent increase compared to a nationwide figure of 2.4 percent during the same period. Houston's unemployment figures are consistent with this trend, dropping from 6.7 percent to 5.4 percent over the same time frame. This is a very substantial decline considering the deep recession which Houston experienced over the past few years. The decline in Houston's unemployment rate is significantly more than the national unemployment rate, which declined from 5.6% to 5.2% during the same period.

Before passing legislation to make permanent changes in the program to solve the revolving fund problem, the fundamental

question of why the program was created and the constituency which it serves must be carefully analyzed.

INTENT OF THE MORTGAGE INDEMNITY ACT

The Mortgage Indemnity Act was passed last year to try to gain solvency in the VA Home Loan Guaranty Program. NAHB is concerned, however, that this legislation will not achieve its required objective of making the program actuarily sound. Moreover, it must be brought to the Committee's attention that the indemnification program will fundamentally change the entitlement nature of the current VA loan program. Changing forty-five years of history which have successfully served over 12.5 million veterans, needs to be carefully and thoroughly considered.

Under the Subcommittee bill (H.R. 1415), which is similar to last year's legislation (H.R. 5221), the veteran would no longer pay a 1 percent funding fee, but would instead pay a 1 1/4 percent indemnification premium. The government would "share" in this program by contributing a 1/4 of one percent premium during each of three years. A veteran making a downpayment of 5 percent or more would only pay a 3/4 percent fee. These collections are to be placed in a second revolving fund called the Veterans' Mortgage Indemnity Fund. Premium collections would be used to establish a reserve fund to offset future losses from foreclosures and the veteran would be absolved from debt by the VA should the loan go into default.

As you are aware, we have expressed reservations about the changes the mortgage indemnification plan will make in the program. While the program may have the appearance of working, there are many concerns which must be examined before passing this legislation:

1) A two percent indemnification fee (including the 1 1/4 percent veteran fee and 3/4 percent government fee) may be insufficient to cover losses in the program on new loans. The indemnification fee may have to be higher to make the program actuarily sound. In all likelihood, some initial capital infusion or additional appropriation may be necessary, as well.

A recently released Peat Marwick study on mortgage insurance options for the VA Home Loan Guaranty Program includes comments on the Mortgage Indemnity Act. The report emphasizes that a deficit balance is created under the indemnity bill. The report states:

> Given the present structure of H.R. 5221, the Mortgage Indemnification Fund Balance goes to a deficit balance by 1993, from which it does not emerge through the year 2023. Investment income provides little benefit under this program since the Fund's balance becomes negative after four years. The increase in funding fee income generated by this program appears negated by the additional risk of foreclosure associated with the removal of liability from a veteran upon defaulting on a VA loan.

We suggest that the VA be asked to determine what level of government contribution would be required to make

the program work. We urge that it not be an increase in the veteran's contribution.

For single family programs under HUD to be actuarily sound a 3.8 percent premium is collected and that program requires a downpayment. It has also accumulated reserves over the years to protect the program. The mortgage indemnification program would not have the benefit of established reserves.

The Congressional Budget Office (CBO), however, has estimated that a two percent loan indemnification fee is adequate and that, not only would the program be actuarily sound from the beginning, but there would be a one billion dollar surplus at the end of ten years.

Some of the assumptions made by CBO in its forecasts, however, appear overly optimistic. For example, CBO estimates that default rates under the Mortgage Indemnity Fund (MIF) will be more favorable than recent experience requiring fewer outlays. Yet, under the indemnification program, the veteran is released from liability if the loan goes into foreclosure, which could cause much higher default rates.

The CBO has also stated in a separate report that FHA is exposed to a greater financial risk under its 203(b)

program than the VA under its Home Loan Guaranty Program, because it insures the entire loan principal whereas the VA program only insures it in part. This implies that a lower premium is needed for VA. It is important to point out, however, that the loss is about the same under both programs except in a catastrophic situation. The average loss to each agency if a loan goes into default in normal times is about $16,000 whether it is an FHA insured loan or a VA guaranteed loan. Therefore, we question, again, whether a 2 percent fee is enough.

2) Under H.R. 5221 and H.R. 1415, a veteran who makes a downpayment of 5 percent or more would only have to pay a 3/4 percent fee. This could reduce the fee for over 25 percent of veterans who make a downpayment. With less money coming into the fund, the self-sufficiency factor could again be overestimated. This would also cause new homebuying veterans, who would be less likely to have a downpayment, to pay more, the opposite of what the Committee should be trying to achieve.

3) Two revolving funds would now exist and neither one would be self-sufficient. The current Loan Guaranty Revolving Fund (LGRF), which is not backed by loss reserves would continue to need capital infusions to pay for losses. The LGRF would no longer benefit from

new loan fees coming in to supplement the fund. The Mortgage Indemnity Fund not only does not help supplement the LGRF but would require appropriations for the government's share of the premium. The federal government would then have to appropriate funding for two separate revolving funds that are not self-sustaining.

4) Because the government is making a contribution to the new Mortgage Indemnity Fund on behalf of the veteran, an estimate of this amount would have to be appropriated each year by the Congress. We are concerned that this estimate may not be enough to cover the government's cost and that you will, in effect, put an artificial ceiling on the program. A similar experience occurred in 1986, when, under the requirements of the sequestration provision of the Gramm-Rudman-Hollings Deficit Reduction Act, Congress twice had to raise the ceiling on the aggregate loan amount needed to fund the program. This caused unnecessary delays in administration of the program. While the VA Home Loan Guaranty Program was subsequently exempted from the sequestration provisions which created the ceiling, the Mortgage Indemnity Act would create another one.

5) One of the fundamental purposes of the Mortgage Indemnity Act is to release the Veteran from liability if his loan goes into foreclosure. For this "indemnity," he would pay an increased fee. It is important to point out, however, that the veteran may be getting only partial protection under the Mortgage Indemnity Act. The indemnification provision in the legislation only gives protection from the Veterans Department, not from losses that may be incurred by the lender. If the Administration continues its "no bid" policy whereby the lender ends up with a foreclosed property rather than the VA, fewer veterans will realize the full benefit of this provision. In 1988, almost 25 percent of VA foreclosed properties were "no bids." This means that one in four who are buying indemnification are not fully getting it.

Additionally, many states have passed anti-deficiency laws, which prohibit deficiency judgments against veterans who have already had the trauma of losing their home. The veteran would be buying mortgage indemnification to protect against something that many state laws already prohibit.

And finally, the committee must thoroughly analyze the precedent setting nature of the action being proposed. For example, could this kind of relief be made

available to veterans under the existing program? What about borrowers under other federal programs?

In conclusion, we are concerned that the Mortgage Indemnity Act, which makes sweeping changes in the program, may not achieve its stated objective of making the Home Loan Guaranty Program actuarily sound. Retaining the benefits of the program must also be considered when making changes in this long standing entitlement program.

PEAT MARWICK STUDY

The Peat Marwick report, as we previously mentioned when analyzing H.R. 5221 (H.R. 1415), outlines a series of funding options designed to make the VA Home Loan Guaranty Program self-sufficient. Since this is an extensive report which has just been released, we have not had sufficient time to analyze it thoroughly. However, we have made some preliminary observations and tentative conclusions which we would like to share with you.

We are pleased that the VA in its direction to Peat Marwick emphasized that the no downpayment feature of the VA Home Loan Program should be maintained. The no downpayment feature is the mainstay of the VA housing entitlement benefit and should not be tampered with.

We feel that some of the options of the study are extreme. We do not support two, three, four and five hundred percent increases in the funding fee as called for in some options. Nor do we accept the idea of requiring excessive interest rate

surcharges on the program which could add hundreds of dollars to a VA loan and may not be tax deductible.

However, we are supportive of the concept of "cafeteria options" which permit both borrowers and lenders to purchase added program benefits such as additional entitlement and free assumability. This kind of innovative flexibility would enhance the overall program utility. For example, purchasing a larger guaranty amount or entitlement would allow a veteran to take out a larger loan. Currently, the maximum guaranty of $36,000 will support a loan of $144,000. If the veteran pays to raise the guaranty to $40,000, he could take out a loan of up to $160,000 (4 times the guaranty amount). This would be very beneficial to veterans in high cost areas and adds flexibility to the program.

NAHB has created a working group on VA housing issues that will be meeting during our Board of Directors meeting in mid-May. We would be pleased to share its findings and comments on this report and other VA issues of importance to the Subcommittee.

Additionally, while we do not know whether the Senate will again introduce legislation to establish an Independent Commission to address solvency issues, it could be another avenue to pursue as we seek solutions to problems the program is currently experiencing. We look forward to working with you to develop viable solutions to the VA Home Loan Guaranty Program.

## ADJUSTABLE RATE MORTGAGES/RISING INTEREST RATES

When we testified before the Subcommittee in February, we again supported a VA adjustable rate mortgage (ARM) for veteran

homebuyers. We are pleased that the House passed an ARM pilot program during deliberations on the 1987 VA Housing bill, but are disappointed that it was dropped in conference. We urge that a pilot program be implemented again but urge that it be demonstrated in more than one regional office, including a high cost area. The Subcommittee might also consider a nationwide demonstration similar to that originally established under the Federal Housing Administration (FHA) program, which was set at 10 percent of the previous year's mortgage loan activity.

The Veterans Department is the only major mortgage market participant without an ARM, yet 60 percent of the loans made last year were ARMs. A VA ARM is necessary to modernize the VA Home Loan Guaranty Program. Last year's Rouse-Maxwell Housing Task Force report, "A Decent Place to Live", also recommends updating the VA program to include an adjustable rate mortgage. The report emphasizes that an ARM is necessary to make the program fully responsive to market developments.

## ARM Features

Provision for an adjustable rate mortgage would be helpful to better serve the veteran homebuyer, particularly in a period of rising interest rates as we are currently experiencing. More volatile interest rate fluctuations reduce housing activity, and adjustable rate mortgages provide a safety valve in this area. NAHB policy supports an adjustable rate mortgage (ARM) for the VA which allows the lender to make periodic adjustments in the effective rate of interest on a VA home loan based on a national

rate index. An ARM similar to FHA's adjustable rate loan or those offered by the conventional market might be considered. These ARM's limit yearly interest rate rises, as well as the overall rate escalation which acts as a cap. Additionally, a convertible ARM might be considered, which would allow a veteran to convert to a fixed rate loan after a set number of years.

An ARM has proven to be a very responsible, pro-consumer mortgage instrument, and an important option for the homebuyer. Interest rates for an adjustable rate mortgage are typically 1 percent to 2 percent lower than a fixed rate loan. This could result in a savings of over $100 a month in mortgage payments on the average VA loan.

During high interest rate environments, ARMs become an even more attractive option because they carry lower initial rates. As rates fall, ARMs allow the veteran borrower to enjoy rate decreases without the expense of refinancing.

ARM Protections

Concern has been shown that veteran homebuyers are at the lower end of the affordability market and could be negatively impacted by rising ARMs. With prudent credit underwriting and reasonable interest caps, homebuyers should generally not suffer from "payment shock" as upward interest adjustments occur.

Moreover, if the ARM is patterned after the FHA ARM there would be no negative amortization, a significant protection for the consumer. When ARMs were first introduced, there were a

number of variations that allowed for negative amortization -- that is, payments did not cover all of the interest due. Unpaid interest was added to the loan balances and borrowers could end up owing more than the home was worth. This type of loan suffered a very high foreclosure rate and was quickly abandoned. Another significant protection for the consumer is the requirement in the FHA ARM legislation which mandates a written explanation of the features of the ARM. This includes a hypothetical payment schedule that displays the maximum potential increases in monthly payments over the first five years of the mortgage term.

It is important also to point out that the claims rate for foreclosure on ARMs under FHA from the years 1984 through 1988 was often no greater than the overall claims' rate under the FHA's 203(b) program. In fact, during both 1985 and 1987 the claims' rate was substantially lower as is indicated in the following table.

| YEAR | CLAIMS | |
|---|---|---|
| | 203(b) | ARMS |
| 1984 | 12.02% | 12.87% |
| 1985 | 7.74 | 3.45 |
| 1986 | 2.4 | 2.74 |
| 1987 | .49 | .23 |
| 1988 | .3 | .3 |

Since the ARM is limited as a percent of total FHA volume and has only existed since passed by Congress in 1983, claims' data is limited. We are pleased, however, that preliminary statistics are favorable.

We hope that you will support an ARM for the VA homebuyer since the Veterans Department is the only market participant that does not offer such a program. We would be pleased to work with Congress, the Veterans Department and the veterans organizations in establishing a viable ARM alternative under the VA program.

FEDERAL CREDIT REFORM

The National Association of Home Builders strongly opposes credit reform measures which attempt to restrict federal mortgage credit activities of the Veterans Department and other government housing programs. The credit reform legislation supported by the Administration would change the way federal credit programs are treated in the budget. It would require federal agencies to seek direct appropriations from Congress equal to the difference between what private sources would charge for the loan and the fee charged by the government. This approach overstates the cost of the program and reflects the Administration's position that the federal government should have a limited role in providing housing assistance. We reject this proposal and urge Congress to oppose it also, since this is yet another attempt to restrict federal housing credit. For veterans, the entitlement nature of the program is also ignored.

DIRECT APPROVAL OF APPRAISAL REGULATIONS

Mr. Chairman, the National Association of Home Builders appreciates the partnership which we have established with the Veterans Department. We have worked well together to solve problems facing the housing industry. In this regard, we urge prompt implementation of the 1987 VA Housing Act which provides for direct approval of appraisals by VA lenders. Timely appraisals of property are critical in the new home market and this legislation would substantially shorten the time involved to process VA loans. We have been informed by the VA, however, that its regulations will apply only to existing housing, although it will be seeking comments on a pilot program for new construction.

Last year, our Board of Directors passed policy endorsing the immediate adoption of direct approval of appraisals by the VA. We urge you to seek immediate implementation of this program for new construction, as well as existing homes, which will be of particular benefit to new homebuying veterans in the marketplace.

CONCLUSION

Mr. Chairman, in conclusion, I urge that any action of the VA Committee take into account the entitlement nature of the VA Home Loan Guaranty Program. Legislative initiatives which erode the forty-five year benefit of the program should be carefully analyzed by the Congress. Congress must continue the

responsibility of providing assistance to veterans so that they will have the opportunity to obtain affordable housing.

Thank you for allowing us to present our views. I would be pleased to respond to your questions.

STATEMENT OF
THE MANUFACTURED HOUSING INSTITUTE
BY
JERRY C. CONNORS
BEFORE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON VETERANS' AFFAIRS
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
THE HONORABLE HARLEY O. STAGGERS, CHAIRMAN

HEARING ON VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1989

APRIL 18, 1989

MANUFACTURED HOUSING INSTITUTE
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(703) 979-6620

The Manufactured Housing Institute

The Manufactured Housing Institute (MHI) is a national trade association representing manufactured home builders and related suppliers of goods and services to the industry and its consumers. MHI manufacturer members produce approximately 60 percent of the manufactured homes built in the United States today.

The Manufactured Housing Insdustry

The advantages of mass production spawned the development of factory-built housing over 30 years ago. Today there are several forms of factory-built homes, including modular, panelized, and manufactured homes. Our remarks concern themselves with the form of factory-built housing known as manufactured homes, formerly known as mobile homes.

Manufactured homes are delivered from the factory in one or more sections. They are completely assembled and require only minimal labor to make them ready for occupancy once delivered to a home site.

Manufactured homes are built to federal standards prescribed by Congress in the National Manufactured Housing Construction and Safety Standards Act of 1974 (P.L. 93-383). These standards were developed and implemented by the Department of Housing and Urban Development (HUD) in June 1976. As a result of HUD's involvement, these homes are commonly referred to as HUD code homes. Since developing the standards, HUD has maintained its surveillance of the manufactured housing industry, primarily through its agent the National Conference of States on Building Codes and Standards.

Innovative technology, improved aesthetics, and a federal construction code that ensures consistent health and safety standards throughout the U.S. have all played a significant role in making manufactured housing an important part of the permanent housing stock in America.

Since the beginning of the decade through the end of 1988, manufactured home builders have produced 2.270 million homes, accounting for 14.3 percent of the 15.817 million privately-owned housing construction started during the decade. The 1985 American Housing Survey, the most recent of the biannual housing surveys published by the Department of Commerce, indicates that there were 88.4 million full-time occupied housing units at the end of 1985, including manufactured homes. Full-time occupied manufactured homes accounted for 4.8 million, or 5.4 percent, of the total occupied housing units in the U.S. at the end of 1985 according to the survey.

The Veterans Administration Manufactured Home Loan Program

The Veterans Administration (VA) was first authorized to guarantee loans on manufactured homes by the Veterans' Housing Act of 1970 (P.L. 91-506). The 1970 Act provided for termination of the Program on July 1, 1975 to give Congress time to evaluate it. The Program became permanent with the passage of the Veterans' Housing Act of 1974 (P.L. 93-569), and Congress affirmed its belief that the VA Manufactured Home Loan Guaranty Program was beneficial and provided a good source of housing to veterans.

The Program has provided more than 111,000 veterans the opportunity to own their own home from its inception through 1988. For this reason, we believe that it is an important and valuable part of the overall benefits provided to veterans through the various activities carried out by the VA.

Manufactured home loans guaranteed by the VA are eligible for pooling into Government National Mortgage Association (GNMA) mortgage-backed securities. So, the VA Program also provides an important access to loan funds available through institutional investors and others who buy GNMA securities. Access to investors through secondary markets has become an increasingly important source of funds for housing finance in the 1980's. And, at this time, GNMA is the only organized secondary market source for publicly traded securities backed by manufactured home personal property loans.

Mortgage Indemnity Fund

We support the goal of strengthening the VA Home Loan Guaranty Program because we believe it provides an important benefit to veterans that they deserve to have continued. We are concerned, however, that the creation of a mortgage indemnity fund may not fully accomplish that purpose. And, the indemnity fund places a large part of the burden of paying for the program squarely on the backs of veterans. It could drive veterans from the Program, and as a practical matter, the imposition of a fee introduces a fundamental change in the nature of the Program.

Collecting a fee for using the Program has the effect on the veteran of changing the benefit program to an insurance program where most of the premiums are collected at the beginning of the policy. To the extent that the mortgage indemnity fund proposal takes the VA Program in the direction of an insurance program, it could lead to the abolition of the Program by its merger into the Federal Housing Administration (FHA) loan insurance programs.

Certainly the VA revolving fund cannot continue to sustain losses, as it has over the last two years, without seriously jeopardizing the entire VA program. We all know that new money for programs such as this one is not in the cards, at least for the near future, and there is continuing pressure to reduce the federal budget deficit. Additional authorizations may be necessary over the next several years to pay for additional losses in the absence of some kind of self funding program such as the one proposed. We know those to be the realities, but we question the fairness of the mortgage indemnity fund proposal to the veteran, who has every right to expect the same benefits as those who served before him.

Introducing a 1 1/4 percent fee into the transaction adds to the loan balance without adding to the value of the collateral. So, if the borrower is unfortunate enough to be in an area of the country where home prices are not rising rapidly, experiences the loss of employment, illness, or some other unfortunate event early in the loan, it will lead to a default on the loan and a loss to the VA. The borrower will not have paid off enough principal to build any equity, prices will not have risen enough to build equity, and the difference between the value of the home and the loan balance will have been made greater by the indemnity fee.

While financing the mortgage indemnity fee has detrimental effects, in our opinion, requiring that it be paid in cash would be even more devastating. That would make the purchase of a home under the program virtually impossible for the low and moderate-income veteran. It would eliminate most, if not all, of the advantage of the no downpayment feature of the VA Home Loan Guaranty Program.

We would respectfully submit that the introduction of a mortgage indemnity fee would work to the detriment of the veteran borrower. While it might turn the Program into a pay-as-you-go program, it would undermine the benefit nature of the Program to the veteran. That would be an unfortunate disservice to the thousands of men and women who have sacrificed so much in the service of their country.

Downpayment on Manufactured Home Loans

For veterans who purchase a manufactured home with a loan guaranteed by the VA, the benefits of the program have already been reduced. The Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987 (P.L. 100-198) imposed a five percent downpayment requirement on loans secured by a manufactured home. This is a major departure from the no downpayment feature of the VA Home Loan Guaranty Program generally. Loans secured by site-built homes still require no downpayment under the VA Program.

It seems incongruous that veterans purchasing more expensive site-built homes may do so with less cash than veterans purchasing manufactured homes. Veterans who purchase manufactured homes generally are borrowers with low to moderate incomes who cannot qualify for a loan on a site-built home. The added burden of a five percent downpayment makes the purchase of a manufactured home even more difficult, and in many cases, prevents the veteran from using a benefit earned from years of service in the armed forces.

Since the implementation of the downpayment requirement on manufactured home loans in February 1988, loan volume in the Program has slowed to a trickle. Only 1,674 manufactured home loans were guaranteed by the VA in 1988, the lowest annual volume in the Program since its inception almost 20 years ago. Monthly loan volume has declined from an average of 200 to 400 loans per month to less than 100 per month.

We would urge the subcommittee to eliminate the downpayment requirement on VA-guaranteed manufactured home loans, return the Program to a parity basis with its site-built housing program, and return the benefit to the veteran this requirement took away.

Conclusion

We appreciate the opportunity to offer our views before the subcommittee. We feel that the VA Home Loan Guaranty Program has served veterans well and that they deserve to continue to receive its benefits.

We appreciate the concern about losses in the program that the mortgage indemnity fund is intended to address. However, we feel that the imposition of yet another fee will dilute the benefit of the program to veterans and deny them the opportunity of home ownership that they so richly deserve.

We would be happy to answer any questions or provide any additional information or assistance that the subcommittee may need.

NCOA

Non Commissioned Officers Association of the United States of America

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Statement of

Richard W. Johnson, Jr.
Director of Legislative Affairs

before the

Subcommittee on Housing and Memorial Affairs
Committee on Veterans' Affairs
U.S. House of Representatives

on

Mortgage Indemnification

April 18, 1989

*Chartered by the United States Congress*

Mr. Chairman. The Non Commissioned Officers Association extends to the committee and its staff sincere appreciation for the effort that is being devoted to making the veterans home loan guaranty program more viable. Notwithstanding the philosophical and technical disagreements which exist between NCOA and the committee, we commend and admire the zeal demonstrated by committee members and staff in seeking to preserve loan guaranty for veterans. That, of course, brings us to the topic of today's hearing. The committee has invited testimony on a draft bill to create a Mortgage Indemnification Program as a successor to the loan guaranty program.

## Philosophical Difference

Mr. Chairman, as NCOA has previously stated we have a philosophical difference of opinion about the best way to preserve home loan benefits for veterans. Fundamentally, NCOA believes the recapitalization of the loan guaranty revolving fund together with the establishment of a direct loan program would be in the long-term best interest of veterans. Recapitalization and direct loans offered together with several forms of optional insurance (including loan indemnification) could eventually rebuild a portfolio capable of operating the loan guaranty program with minimum appropriations and without taxing veteran participants. Creation of the mortgage indemnification fund would, in the opinion of the Association, be the first step down the road of continuous cost transference to veteran participants.

Recapitalization of the Loan Guaranty Revolving Fund would in our estimation require a $3 billion to $5 billion investment capital infusion. Such a single appropriation is currently beyond the economic reach of Congress. NCOA has recommended recapitalizing the loan fund through investment of veterans' life insurance reserves. This proposal however raises a constitutional issue with regard to the investment of such insurance reserves. In summary, NCOA's idea for insurance reserve investment may not work. Moreover, the Association is convinced that Congress is more interested in exploring alternatives than saving the current program. Thus, we move to consideration of the discussion draft legislation to create a mortgage indemnification program.

## Mortgage Indemnity

The proposal would supplant the veterans home loan guaranty program with a mortgage indemnification insurance program. Veterans wishing to participate in the program would be required to pay a tax equivalent to 1.25 percent of the value of their loan. Veterans who make a 5 percent down payment would pay only a .75 percent tax on the loan. Disabled veterans rated at 30 percent or more would be exempt from the tax. In return, those few veterans who default on their loans would be exempt from indebtedness to the VA as a result of foreclosure losses. This, of course, is the major selling point of the program. NCOA has been instructed to rejoice, veterans will finally be getting something for the tax they pay. At least some veterans will. However, most veterans will notice little change in the program aside from the tax increase.

## NCOA Recommendations

Mr. Chairman, the logic of raising the loan tax from one percent to 1.25 percent for participation in the program continues to elude NCOA. Suggesting that veterans get indemnification for the additional quarter percent suggests the base one percent fee is and has always been necessary. Frankly, NCOA never thought the veteran got anything for one percent. Even when homes go to foreclosure the VA does not currently reduce indebtedness by the one percent tax paid. The Congressional Budget Office (CBO) cost projection on the bill is so optimistic that mortgage indemnification would be quite successful if the one percent tax were retained instead of increased. Frankly, NCOA does not agree that the average veteran

homebuyer gets anything more for the increased tax than he or she gets for the current one percent tax. Neither has NCOA been given any reason to believe the additional quarter percent is necessary to either creation or operation of the mortgage indemnification fund.

Accordingly, NCOA believes government should bear the full burden of cast in loan indemnification. Since this is unlikely, NCOA believes the one percent loan tax should not be increased. If the additional quarter percent is truly necessary then align veterans and government contributions at one percent each. It would be more equitable to have government fund at least half the cost of this experiment since poor government and not veterans are responsible for the failure of the current program.

NCOA further recommends that all loans be treated the same without regard to downpayment. While NCOA understands and appreciates the financial reasons for reducing the tax on loans involving a down payment, the Association does not like the precedent setting nature of the proposal. Since the creation of the agency all veterans have been treated equally in benefit programs. Rich or poor all benefits are the same. The Association sees no reason to change this policy.

In addition, NCOA recommends the legislation be amended to:

o Exempt disabled veterans from tax under conditions and circumstances similar to those provided in current law,

o extend to the Department the authority to make direct loans to veterans as a method of fund investment and,

o specify that taxes should be suspended or eliminated when sufficient fund reserves have been established. Concurrently, provide in law that government contributions may not be reduced until the tax on veteran participants is eliminated.

Finally, NCOA recommends that provisions of the bill authorizing loan sales at 90 percent of face value be eliminated in favor of provisions prohibiting below par sales. On February 23, the VA sold portfolio loan assets worth $278.1 million for 90% of their face value, $255.9 million. However, only 58% of the value was received in cash, $161.4 million. The remaining $94.6 million was received in subordinate certificates - paper - which assumes value only after other investors have been paid. The VA is guaranteed nothing against the value of its subordinate certificates. Yet this qualifies as a 90% loan sale. NCOA can not endorse this kind of sale policy. The losses are intolerably high.

Conclusion

Mr. Chairman, NCOA is less than enthusiastic about abandoning loan guaranty in favor of mortgage indemnity. Unfortunately we cannot find an acceptable way to recapitalize the revolving fund. Accordingly, NCOA supports the committee bill if it is amended to accommodate the Association concerns stated herein. Finally, NCOA again extends its appreciation to the committee for the attention it has given to this most important matter.

Thank you.

STATEMENT OF
STEVE A. ROBERTSON, ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION

before

THE SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

April 18, 1989

Mr. Chairman, The American Legion appreciates the opportunity to appear before this subcommittee today to share our views on proposed legislation designed to deal with the substantial increases in appropriations for the VA Home Loan Guarantee program over the past ten years. We congratulate the subcommittee and you, Mr. Chairman, on the initiative shown by introducing this proposal. We look forward to working with the subcommittee to insure this reform initiative is fair to veterans, fair to taxpayers, and restores solvency to an important program which has assisted almost thirteen million veterans to own a piece of the American dream.

There is a common perception of the VA home loan program as a self-sustaining operation which has recently come to grief solely because of poor management and excessive liberality in evaluating the capacity of the veteran to qualify for a VA guaranteed mortgage. There is another perception that the Loan Guarantee Revolving Fund (LGRF) has, until recently, been self sufficient. Both of these perceptions are largely myth. By its very nature, the Loan Guaranty program is designed to run at a deficit, except for those unusual years when inflation in real estate values permits the VA to recover both its investment in foreclosed properties, as well as property management costs.

During the first seventeen years of the program's life, Congress appropriated monies directly into the VA's readjustment account to cover its costs. In all, Congress provided nearly $730 million for the program between 1944 and 1962, or roughly $3 billion in 1988 dollars. In 1962, the Loan Guaranty Revolving Fund (LGRF) was established for the dual propose of paying program costs and receiving collections from the sale of property and receipt of overpayments. In only eleven of the twenty-six years since 1962 has the LGRF operated at a surplus. Moreover, since the law prohibits carryover of monies in excess of estimated need from one year to the next, a cumulative surplus has never developed in the fund. All funds over and above those estimated to be needed to supplement the receipts of a new fiscal year revert to the Treasury.

Yet, between 1962 and 1984, there was no need to appropriate general revenues for the LGRF, because the fund was sustained by income from another source: the VA's Direct Loan program.

Established in 1950, the Direct Loan program, in which the VA itself is the lender, was developed to meet the mortgage needs of veterans living in areas where private credit was short or nonexistent. The Direct Loan program was initially capitalized through appropriations by Congress, but also relied upon a Revolving Fund into which principal and interest payments were made. During the first six years of the program's life, direct loans accounted for two to five percent of total VA home loan activity. The tight money supply occasioned by the dual recessionary period of 1958-1961, however, greatly increased the demand for direct loans dramatically. In 1961, 16 percent of all VA loans were direct. Thereafter, this proportion declined gradually, owing to the greater availability of private credit, until by 1984, only 8 of the 214,443 VA home loans were direct. In fact, except for rehabilitation loans, the Direct Loan program has been effectively shutdown since March of 1981. Because of the decline in the numbers of direct loans over the years, the principal and interest payments into the Direct Loan Revolving Fund exceeded the demand for loans, and the fund began to develop a large surplus. Monies from that surplus were transferred, as needed into the LGRF, thus obviating the need for appropriations to cover funding for those years in which the LGRF's receipts fell short of its payouts in property acquisitions and claims resulting from foreclosures. Between 1962 and 1984, approximately $1.784 billion was so transferred from one fund to the other.

As the Direct Loan program's surplus increased, the VA came under increasing pressure to sell off part of its portfolio for cash to offset growing Federal budget deficits. As such deficits grew wildly during the early 1980s, the pace of portfolio liquidation increased significantly and income from the program shrank proportionately.

Between 1981 and 1984, nearly $2 billion in the portfolio was sold. The Administration's FY 1989 budget proposes to sell the remainder. Thus the primary source of supplementary income to support the LGRF during lean years has been virtually depleted to effect short term Federal budget savings.

The elimination of the direct loan portfolio as a revenue instrument for its sister loan guaranty program could not have come at a worse time. For over thirty years, the VA home loan program was the beneficiary of not only an ancillary funding source to assist during periods of shortfall brought on by economic downturn, but also benefited from gradual inflationary growth in real estate prices from 1944 to 1977. It is important to realize that prices increased nearly 200 percent during those years. After that period,

however, the sequence of uncontrolled and rapidly accelerating inflation, followed by recession, rising interest rates and growing VA property inventories began to place the greatest strain upon the LGRF since the fund's creation in 1962. Beginning in 1981, the LGRF began to show a widening disparity between the monies it paid out for acquiring foreclosed properties, and the monies received for selling these properties.

In 1982, Congress imposed a 1/2 of 1 percent "user fee" on all new VA Home Loans. Touted as a means of helping to pay for the operational costs of the home loan program, the money was collected and deposited as general revenue in the Treasury. As it became apparent that Congress might have to appropriate funds to sustain the solvency of the LGRF, the fee was raised to 1 percent, and the law provided that its revenues would go to the Revolving Fund.

Nevertheless, in 1984, for the first time in twenty-one years, Congress was forced to appropriate money for the VA Home Loan Program, in the amount of $100 million, and appropriations have been required every subsequent year. The data provided in the President's budget for 1988 and 1989 demonstrates that the funding crisis for the program, far from being over, has ballooned enormously. Unless some reforms are enacted, the LGRF will remain increasingly dependent on massive infusions of general revenue to sustain itself. This prospect is unacceptable to The American Legion, to the Appropriations Committees, and to most veterans in a era of budget deficits.

We have closely examined the proposed legislation and find the creation of an indemnity fund meets the test of being fair to both taxpayer and veterans, while having some reasonable expectation of restoring solvency to the LGRF in three to five years. All of us are aware that the current 1 percent "user fee" is not going to disappear. In fact, the Reagan Administration proposed an increase to 3.8 percent for FY 1990. The funds are needed to keep the program ongoing. Yet this fee, is basically a charge for an entitlement, a concept which The American Legion strongly opposes. Charging a veteran a "premium" which basically buys an indemnity policy for the veteran, at least has the property of providing something of value to the veteran besides access to to a program to which the veteran should have had access in the first place.

Mr. Chairman, it is particularly appropriate that the legislation contains a provision which will insure all monies collected under the provisions of the new section 1824A will be deposited in the fund and invested in "obligations of the United States or in obligations guaranteed as to principal and interest by the United States." These funds must be safeguarded in a manner consistent with good conservative financial practice so that the future solvency of the fund is assured. We also applaud the provision which will insure the realization of current market yields on the investment.

As we understand it, the 1.25 percent premium is to be considered the veterans share of the approximately 2 percent cost of putting the Home Loan Guarantee Program back on a sound financial footing. If the FHA computer model is correct, and we have no reason to doubt that it is not correct, then charging the veteran .25 percent more than he/she would otherwise pay under current law and at the same time providing an indemnity against financial loss should his/her economic circumstances suffer a downturn seems to be a reasonable course to take. At the same time, we should remember that this is, in fact, an entitlement program, and as such should be supported financially in some fashion by the government. Thus, it is appropriate that the government provide .75 percent of the loan as a fee over a period of three years. In our view, the formula is fair to all concerned under the circumstances.

Paragraph (3) of the amended section 1829 contains a provision in the existing statute which allows for the financing of the veterans portion of the fee to be financed over the term of the loan. While this practice can result in a substantial sum of money to be paid by the veteran over the period of the loan, the provision makes it possible for a veteran who has minimal cash on hand to participate in home ownership. Similarly, lenders should not have a problem with this provision since they will collect the interest on the amount paid to the government in the name of the veteran.

We are pleased that the proposed legislation will allow the Secretary to sell loans from the portfolio on a "without recourse" basis as long as the terms of the sale net a value not less than 90 percent of the par value of the loan. We believe that good management practice requires that the Secretary adjust the loan portfolio from time to time, but we also recognize that allowing sales without recourse with no limitations attached to the sale can lead to dumping loans on the market at sales prices far below the par value of the loans, simply to reduce the budget deficit. That is not good financial management practice. The formula in the proposed legislation seems to strike the proper balance between the Secretary's need for flexibility in managing the program, and the need to prevent potential abuses.

Mr. Chairman, we again thank you for the opportunity to participate in this meaningful dialog on solving the problems with the Home Loan Guarantee Program. This entitlement is important to veterans. Thank you very much.

STATEMENT OF
RICHARD F. SCHULTZ
ASSOCIATE NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
April 18, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the more than 1.2 million members of the Disabled American Veterans and its Ladies' Auxiliary, I wish to thank you for the opportunity to present our views relative to H.R. 1415, the Veterans Home Loan Mortgage Indemnity Act of 1989.

Before addressing this measure, Mr. Chairman, we wish to take this opportunity to thank you and the members of the Subcommittee for your efforts to ensure that our nation's veterans will continue to have a viable Loan Guaranty Program to assist them in obtaining mortgage credit without a down payment. The efforts of the Subcommittee over the past several years have had a positive impact on the operation of this valuable benefit program.

As you know, the Loan Guaranty Program has enabled nearly 13 million veterans to obtain favorable credit terms to purchase a home for themselves and their families. Additionally, this valuable program has been good for America's economy, adding stability and expanding the tax base of nearly every community throughout the country.

As we all know, during the early 1980's, the housing and financial markets experienced a shortage of mortgage funds. This, coupled with increased home prices, as well as the highest interest rate in history (17 1/2% in 1982) and the high rate of unemployment, combined to cause the solvency problem of the Loan Guaranty Revolving Fund. Other factors also adversely impacting upon the Loan Guaranty Program included: faulty appraisal practices; equity skimming schemes; kickbacks in the mobile home industry and; false credit reporting.

Furthermore, Mr. Chairman, we are firmly convinced that shortsighted management decisions to sell off large portions of the VA's loan portfolio at bargain basement prices, while bringing immediate cash into the Loan Guaranty Revolving Fund, will, in our opinion, have adverse long-term effects on the solvency of the Loan Guaranty Revolving Fund.

Mr. Chairman, we commend the activities of this Subcommittee and those of its counterpart in the Senate which have resulted in positive steps taken by Congress to institute better management practices within the Loan Guaranty Program and protect it from fraud and abuse by individuals who wish to profit at the expense of our nation's veterans and the American taxpayer. However, while recent actions taken by Congress ensure that the fundamental purpose of the Loan Guaranty Program -- assisting eligible veterans obtain mortgage loans without a down payment -- remains intact, it is clear that these actions alone cannot solve the ongoing financial crisis of the Loan Guaranty Revolving Fund.

H.R. 1415
The Veterans Home Loan Mortgage Indemnity Act of 1989

This measure, introduced by yourself Mr. Chairman, with Full Committee Chairman Montgomery and Ranking Minority Member Stump, proposes to:

*discontinue the current 1% users fee;

*establish a 1 1/4% mortgage indemnity fee (based on the total loan amount) where the down payment is less than 5%;

*establish a 3/4% mortgage indemnity fee (based on the total loan amount) in those cases where the veteran has a minimum 5% down payment;

*require the government to pay a 1/4% premium (based on the original loan amount) per year for three years;

*exempt veterans rated 30% or more service-connected disabled from paying the mortgage indemnity fee;

*set-up a special account to receive the fees;

*authorize the excess monies to be invested in government securities;

*continue the 1% fee for vendee loans and the 1/2% fee for assumed loans;

*retain the current program for those loans guaranteed prior to enactment of this measure;

*allow the sale of loans with or without recourse only if at least 90% of the loan value is received at time of sale;

*change computation of entitlement amount; and

*modify Section 3101, Title 38, USC pertaining to the waiver of debts.

Mr. Chairman, while the DAV has always been opposed to requiring a veteran to pay for the privilege of using an earned benefit entitlement, we fully recognize the financial dilemma of the Loan Guaranty Revolving Fund. If veterans are to be required to pay for the use of the Loan Guaranty Program, they should, at the very least, be protected against further financial hardship should unfortunate circumstances cause them to default on their VA guaranteed loans. This, we believe, represents a more meaningful use of taxpayer dollars and the fee paid by veterans.

However, Mr. Chairman, we strongly believe that all service-connected disabled veterans utilizing the Loan Guaranty Program should be exempt from the mortgage indemnity fee on the same basis as they are currently exempt from paying the current loan origination fee. Therefore, we respectfully request that H.R. 1415 be amended to delete the requirement that veterans rated at 10% and 20% service-connected disabled be required to pay the mortgage indemnity fee.

Mr. Chairman, Section 3 of your bill will permit the Department of Veterans Affairs to sell vendee loans with or without recourse so long as the amount received at time of sale is not less than 90% of the unpaid balance of the loan. The DAV supports this provision as we view the current policy of selling loans without recourse bringing only $.55 or $.56 on the dollar, to be short-sighted with long-term detrimental effects on the Loan Guaranty Revolving Fund.

The DAV, also supports Section 4 of your bill changing the computation of entitlement amount.

Section 5 of H.R. 1415 would modify existing provisions of law pertaining to waiver of recovery of indebtedness, including indebtedness incurred through the Loan Guaranty Program.

In the absence of fraud, the DVA has traditionally considered two thresholds in waiver determinations: material fault on the part of the debtor, and the debtor's ability to repay the indebtedness. Generally speaking, if significant material fault on the part of the debtor is shown, further consideration under the standard of equity and good conscience is precluded, and the claim for waiver denied.

On the other hand, if less than total material fault on the part of a veteran is shown, DVA is required to apply the standard of equity and good conscience and consider such factors as the veteran's ability to repay the debt, given his current assets, income, liabilities, hardship, etc. These factors may then dictate favorable resolution of his request for a waiver.

On occasion, it is determined that there exists a proximate balance of material fault in the creation of indebtedness on the part of the DVA and the debtor, and a claim for waiver will be denied based on a determination that the debtor has (or in the future is likely to have) the ability and financial resources to repay the indebtedness.

Mr. Chairman, your proposal would preclude an adverse waiver determination by the DVA for Loan Guaranty indebtedness solely on the basis of a balancing of fault between the DVA and veteran in the creation of this indebtedness. DVA would then have to afford the veteran consideration under the equity and good conscience standard. Mr. Chairman, we support this proposal.

Likewise, Mr. Chairman, we also support that portion of your proposal that would preclude an adverse loan guaranty waiver determination based solely on whether the veteran might be able to repay the indebtedness. Currently DVA personnel charged with making waiver determinations are readily aware of the amount of monthly compensation a service-connected disabled veteran receives.

As you know, compensation is intended to "make up" for earnings impairment experienced due to a service-connected disability, and these funds are normally used by veterans to pay for such necessities as food, housing, education, and medical expenses for themselves and their families.

We believe DVA frequently denies claims for waiver of indebtedness for service-connected veterans in receipt of compensation (sometimes, even though there may be a proximate "balancing of fault" in the creation of indebtedness) since they know they can recoup this indebtedness from future compensation payments. Thus, compensation paid to a veteran for his service-connected disabilities -- and used by him to support a broad array of expenses incurred by his family -- is withheld in whole or in part until the indebtedness is liquidated.

We believe the modification contained in Section 5 of H.R. 1415 would be beneficial for all veterans and result in more equitable waiver determinations for those veterans who incur a home loan guarantee indebtedness. We therefore support this provision.

In conclusion, Mr. Chairman, the DAV again wishes to commend you and the members of the Subcommittee for your outstanding efforts to provide for the fiscal solvency of the

Loan Guaranty Revolving Fund. If this valuable benefit entitlement program is to continue to provide meaningful assistance to eligible veterans, it is imperative that timely action be taken. With the exception of the provision which requires service-connected disabled veterans rated at 10% and 20% disabled to pay the indemnity fee, the DAV supports H.R. 1415, the Veterans' Home Loan Mortgage Indemnity Act of 1989.

This completes my statement Mr. Chairman. Again, we wish to thank you for the opportunity to present our views on this important measure.

STATEMENT OF

DENNIS M. CULLINAN, ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

BEFORE THE

SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO

VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1989

WASHINGTON, D. C. APRIL 18, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the over 2.9 million members of the Veterans of Foreign Wars of the United States and its Ladies Auxiliary, I wish to sincerely thank you for including us in this forum here today which will address the financial health and continued operation of the Department of Veterans Affairs Home Loan Guaranty Program. It is, as always, both a pleasure and a privilege to take part in an effort to improve a program which has been so profoundly beneficial to the nation and this nation's military veterans. The Veterans of Foreign Wars remains firmly committed to working for the improvement of this invaluable veteran's program.

To be addressed today is proposed legislation which is entitled "Veterans' Home Loan Mortgage and Indemnity Act of 1989." It is our assessment that this legislative proposal would essentially create a new, more fiscally sound home loan program. The current one percent user fee would be eliminated and replaced with an indemnity fee of 1 1/4 percent which would be collected from veterans utilizing the program. Additionally, for each housing loan guaranteed or insured under the new program, an amount equal to .25 percent of the original amount of the loan would be credited by the government into the Indemnity Fund for three fiscal years. This special fund would then be used to pay for the operation of the "new" home loan program and the DVA would also be mandated to invest any excess funds so that this revolving fund would become self-sustaining. This new program with its newly established revolving fund would be separate and apart from the current home loan program and, therefore, revenue generated would be used to offset future losses rather than pay claims on loans previously closed. This approach is intended to allow for build up of reserve which would ultimately improve the long-term solvency of the program.

In this regard, the VFW has in the past supported enhancing the current DVA Home Loan Guaranty Program's assets by increasing its portfolio of vendee loans since they generate collections in the form of principal and interest payments. It is our contention that the current program's problems are directly due to OMB having forced the program to sell off a large portion of its best loan assets in past years, thereby severely eroding its ability to generate its own funding. We point out that if the program were allowed to rebuild its portfolio of vendee loans, it would eventually become, once again, self-sustaining. However, we also acknowledge that in all likelihood this would take 10 to 15 years. We are also painfully aware of the large appropriations now required to keep the program running. Therefore, creating a "new" home loan program which is free from the current program's OMB precipitated folly and debt makes sense.

The VFW favorably notes that the 1 1/4 percent indemnity fee that would be charged veteran borrowers would in turn release these individuals from liability in the event of default. It is a matter of record that the Veterans

of Foreign Wars strongly opposes any increase in the user fee for a DVA guaranteed home loan. However, we do recognize that if the current one percent funding fee were replaced with a 1 1/4 percent indemnity fee, the veteran would at least get something for his money. That is, if a veteran's loan goes into default, the veteran does not incur the financial burden of having to repay the DVA for any money lost. At a time when an individual does not even have enough money to keep his own home, such debt can be absolutely devastating. Therefore the VFW strongly supports the implementation of a mechanism for releasing veterans from financial liability to the DVA in the event of foreclosure.

The Veterans of Foreign Wars supports this legislative proposal inasmuch as it would serve to strengthen and preserve a program that is proven to be an invaluable asset to both veterans and the nation while providing veterans with highly desirable additional mortgage protection in the event of foreclosure. Even so, we would emphasize that we may only back this proposal with the understanding that once the DVA Home Loan Program has been restored to financial health that the "mortgage indemnity" fee itself will be eliminated and veterans will no longer be required to pay to participate in the program. It is also our recommendation that once the fee has been eliminated and the DVA Home Loan Program is operating solidly in the black, that the available funds be used to revitalize the vendee loan portfolio so as to ensure the long-term financial health and improved operation of the home loan program for this nation's veterans.

Taken as a whole, the VFW views this legislation to establish a new and financially independent home loan program as a bold and innovative initiative, which is certainly moving in the right direction toward fulfilling a VFW mandate as enumerated in our current VFW Resolution Number 615, entitled "VA Home Loan Guaranty Program" that asks "...that legislation be introduced that will serve to maintain the VA Home Loan Guaranty Program as the most viable and desirable means of home financing for veterans." (Please find attached the VFW resolution for your consideration.) Mr. Chairman, you are to be congratulated for having introduced this bill.

Mr. Chairman, I sincerely thank you and the other members of this Subcommittee for including the Veterans of Foreign Wars in today's hearing. I will be happy to respond to any questions you may have.

Resolution No. 615

VA HOME LOAN GUARANTY PROGRAM

WHEREAS, the VA Home Loan Guaranty Program is one of the most popular and beneficial programs available to veterans; and

WHEREAS, the wide use of this program is evidenced by the fact that over twelve million loans have been guaranteed to date in an amount exceeding $280 billion; and

WHEREAS, loan origination fees have been enacted and subsequently increased in an effort to remedy the ailing revolving fund; and

WHEREAS, constructive changes have been implemented or proposed in the VA Home Loan Guaranty Program, such as granting the VA Administrator the authority to (a) independently set loan interest rates; (b) improve the formular for establishing the loan guaranty percentage/maximum amount; (c) provide mortgage payment assistance to avoid foreclosure; and (d) amend the VA foreclosure policy to enhance the VA Loan Guaranty Revolving Fund, hence strengthening the program; now, therefore

BE IT RESOLVED, by the 89th National Convention of the Veterans of Foreign Wars of the United States, that legislation be introduced that will serve to maintain the VA Home Loan Guaranty Program as the most viable and desirable means of home financing for veterans; and

BE IT FURTHER RESOLVED, that the Veterans of Foreign Wars vigorously opposes any effort to further increase the current loan origination fee or eliminate the VA established loan interest maximum, and encourages the Administrator of Veterans Affairs and other concerned parties to actively assist veterans in acquiring and retaining their homes during economic crisis.

Adopted by the 89th National Convention of the Veterans of Foreign Wars of the United States, held in Chicago, Illinois, August 19-26, 1988.

Resolution No. 615

STATEMENT OF
JOHN C. BOLLINGER, ASSOCIATE LEGISLATIVE DIRECTOR
PARALYZED VETERANS OF AMERICA
BEFORE THE
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
OF THE
HOUSE COMMITTEE ON VETERANS' AFFAIRS
CONCERNING
H.R. 1415, THE "VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1989"
APRIL 18, 1989

Mr. Chairman and Members of the Subcommittee, on behalf of the members of PVA, I wish to thank you for this opportunity to present our views concerning your proposal to establish a new DVA mortgage indemnity program. This initiative and other proposals which address the problems that besiege the Loan Guarantee Revolving Fund have been properly afforded a high degree of visibility as a result of your commitment to the long term solvency of the program. Your willingness to engage in active discussions with the various parties who are directly affected by this vital program has gone a long way toward finding an eventual solution to the current fiscal crisis.
PVA appreciates your unwavering attention to the plight of the loan guarantee program which affects both our nonservice-connected and service-connected members. I wish to point out that the purchase of a home takes on additional significance for over half of our members who are nonservice-connected for their spinal cord injuries. With a significantly smaller pool of available and accessible/adaptable houses, these catastrophically disabled veterans are extremely vulnerable to shortcomings in DVA housing programs. It is for this reason that we take a special interest in the well-being of the program and DVA's ability to administer it.

Various testimonies at the budget hearings before both Senate and House Committees on Veterans Affairs unanimously reiterated the dismal state-of-affairs in both DVA health care and benefit services. Unfortunately, the home loan program is no exception. Although the alarming increase in VA home loan defaults was due, in large part, to factors beyond the control of the DVA, the Administration's continuous assault on staffing levels within this component of the General Operating Expenses (GOE) account has taken a heavy toll on the program's ability to deal administratively with the default situation. If we take no action and this service is permitted to continue its course of billion dollar appropriations, we will certainly see the demise of this once healthy, self-supporting benefit program.

PVA is, therefore, optimistic about your proposal to establish a mortgage indemnity program. We supported similar legislation which was introduced in the 100th Congress and passed by the House last September. We believe its potential effect can be one of landmark proportions and, if enacted, will give the program a fresh start down the road toward fiscal solvency.

Special Indemnity Fund and Loan Fee

Mr. Chairman, the proposed legislation before us today will establish in the Treasury of the United States a revolving fund known as the Veterans' Mortgage Indemnity Fund. This indemnity fund will be available to the Secretary for all operations (other than administrative expenses) carried out with respect to DVA guaranteed or insured loans for which a fee is collected under the Veterans' Home Loan Mortgage Indemnity Act of 1989. The indemnity fund will be established to receive collections and other revenue as well as pay obligations due to the foreclosure of DVA guaranteed loans made after the date this legislation is enacted. Any excess funds will be invested in Government securities.

The establishment of the proposed loan indemnity fee lies at the heart of this legislative initiative. Each veteran or service person will be required

to pay a 1.25 percent fee which can be financed over the lifetime of the loan. For this comparatively small premium, one is purchasing indemnity from the DVA and is therefore protected from financial devastation due to indebtedness to the government on a defaulted home loan. Although this does not prohibit a lender from exercising a deficiency judgement against a veteran, we believe the fee represents a good investment in an individual's financial security as well as contributing to the overall fund. In addition to this security, the individual will continue to benefit from the entitlement features of the program - little or no down payments, lower than conventional interest rates, and one point maximum payments to the lender. The draft bill also contains a provision which would exempt veterans who are rated 30% service-connected or more from paying the fee. PVA is grateful for your consideration of these individuals.

During discussions of similar legislation which was proposed last year, we were assured that the loan indemnity fee would not be increased over the proposed 1.25 percent. We are hopeful that this legislation has the same intent. Further, PVA believes that once this new program gains a secure financial footing, the fee should be reduced or eliminated altogether.

There is no question that over the past decade veterans have been asked to pay more and more in the form of fees, contributions, and co-payments toward various benefit programs and health care. We believe this trend should be carefully monitored and, to every extent possible, reversed. This Subcommittee and the Congress have always made certain that those men and women who have served our country are returned to a society in which they can compete both educationally and financially with their non-veteran counterparts. For the sake of a program, it is occasionally necessary for a veteran to contribute to the overall well-being of the program. We must be cautious, however, that such fees and contributions do not become a "bail out" mechanism for short-sighted and improper management techniques. Likewise, we are concerned that the use of such fees and contributions will become an easy method by which deficit-reduction can be addressed. PVA encourages this Subcommittee to closely monitor the necessity of the loan indemnity fee and make appropriate adjustments as the program matures.

We believe it is important to justify our support of the indemnity fee by making a brief comparison to the existing funding fee which we have historically opposed. When an individual currently pays the one percent funding fee, he or she gets nothing in return. The fee has little bearing on the individual's loan or, for that matter, on any new loan. Such fees, and the numerous increases which had been proposed by the Administration over the years, are used primarily to pay for the high foreclosure rates on old loans and costly administrative decisions made by the DVA. Consequently, the existing loan guarantee revolving fund requires large supplemental subsidies every year to keep the program afloat. We can no longer afford to continue extinguishing brush-fires in the program at the expense of the American taxpayer. The fire-storm which now threatens the DVA Home Loan Program necessitates a significant shift in strategy from the billion dollar appropriation approach.

The proposed loan indemnity fee and the current funding fee, although different by only one quarter of one percent, are vastly different in concept. We are pleased to support the fee contained in the Veterans' Home Loan Mortgage Indemnity Act of 1989.

Government Contributions and Other Fees

As a result of inter-agency research, it was determined that 2 percent of each guaranteed loan amount would be needed to make the proposed mortgage indemnity fund operate on a sound fiscal basis. Therefore, in addition to the veteran's fee of 1.25 percent, your proposal would require the Government to subsidize .25 percent of each loan for three fiscal years beginning with

the fiscal year in which the veteran's fee was collected. The total Government subsidy would be .75 percent over the three year period. Although PVA can currently support this ratio between the veteran's fee and the Government's contribution, we must reiterate our position that this formula should be adjusted in favor of the veteran when the indemnity fund becomes solvent in several years.

We believe the other fees proposed in your draft bill - .75 percent instead of 1.25 percent if the veteran makes a down payment of not less than five percent of the purchase price or construction cost, and .5 percent from a person who assumes a DVA loan, are proper initiatives.

Sale of Vendee Loans

PVA supports Section 3. of the draft bill which states that the Secretary may sell a vendee loan with or without recourse, but only if the amount received at the time of such sale is equal to an amount which is not less than 90 percent of the unpaid balance of such loan. We believe this provision gives the Secretary a reasonable degree of flexibility when transacting the sale of vendee loans while, at the same time, prohibiting such sales at outrageously low prices.

Computation of Entitlement Amount

PVA concurs with this proposed change to Section 1802(b) of title 38, USC. The addition of the phrase, "(3) the loan has been repaid in full", properly rounds out the Secretary's authorization to compute the aggregate amount of guarantee or insurance for housing loan entitlement available to a veteran under Chapter 37.

Waiver

This legislation proposes that the Secretary may not make a determination with respect to equity and good conscience under the DVA home loan program solely on the basis of a balancing of fault or whether the veteran might be able to repay the indebtedness. We concur with this amendment.

Conclusion

Mr. Chairman, this Subcommittee and committee staff have devoted a great deal of time to devising a home loan program that will, once again, put us on the road toward solvency. The mortgage indemnity proposal must be put in place as soon as possible in order for the DVA to carry on the tradition of guaranteed mortgages for veterans. It represents the future of what has been, since 1944, an extremely successful benefit program. We gladly support your bill.

That concludes my testimony. I will be pleased to answer any questions you may have.

Vietnam Veterans of America, Inc
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Suite 700
Washington, DC 20009-1125

(202) 332-2700

STATEMENT OF

VIETNAM VETERANS
OF AMERICA, INC.

Presented By

PAUL S. EGAN
LEGISLATIVE DIRECTOR

Before the

HOUSE VETERANS AFFAIRS SUBCOMMITTEE ON
HOUSING AND MEMORIAL AFFAIRS

on

# VETERANS HOME LOAN GUARANTY PROGRAM

APRIL 18, 1989

Mr Chairman and members of the Subcommittee, the Vietnam Veterans of America, Inc. (VVA) appreciates this opportunity to present its views on the DVA's home loan guaranty program generally and, to the extent that we can, on the proposed legislation under consideration today. We wish to state at the outset that while we harbor several very serious reservations about the legislation at hand, it may be the only interim way of enhancing the program's survivability under the current fiscal circumstances.

In this connection, we share the views of the Non Commissioned Officers Association that the most appropriate way of restoring the program to its previous status and solvency is through recapitalization. The loan guaranty revolving fund (LGRF) should most appropriately be refinanced through a rebuilding of its income-generating portfolio of home loans.

We also strongly believe that the DVA ought to be given authority to move aggressively toward rebuilding this portfolio. The means for doing this, among others, might require a more vigorous direct loan program along with less deference to the interests of bankers when choices are made following default as to whether the guaranty (the less expensive option) should be paid or whether the DVA should simply bail out the banks and acquire deed to the property.

After having said this, we are realistic enough to believe that recapitalization is a possibility beyond the realm of likelihood. Similarly, adopting an aggressive direct loan policy is unlikely given the characterization of competition with the private sector that such a policy might invite. As for adopting a policy on "no bids" that puts the best interests of the program's well-being ahead of that of the banks would undoubtedly be characterized as ultimately disadvantageous to veterans who might be hard pressed to find lenders willing to do business with the DVA.

The legislation under consideration today, in our view, represents a response to the culmination of several problems besetting the program for years. The early 1980's brought with them record foreclosure rates that continue to this day. Accompanying these foreclosure rates, the earlier mentioned short-sighted policy of finding interim budget deficit savings by selling off the home loan portfolio was put into place. Initially the foreclosure rates were attributed to the deep recession of the early 1980s. Nevertheless, the strain on the LGRF has been relentless. As we all now know, billions of dollars have had to be appropriated to keep the LGRF solvent and the overall program afloat as foreclosure rates have remained unacceptably high several years after the recession.

We have also seen the imposition of user fees for those wishing to take advantage of the program. First it was a half percent, the proceeds of which were directed toward the Treasury. The half percent became one percent, the proceeds of which were redirected to the LGRF. In the meantime, we have seen unsuccessful proposals to impose negotiated interest rates and adjustable rate mortgages on veteran users. In each of these proposals, those that have been enacted as well as those that have not, paying the cost of either reducing the deficit or bailing out the program has always been directed toward the veteran user; the only population that has failed to make a profit in the classical sense from the program.

The legislation under consideration today would replace, either in whole or in part, the user fee with a 1 1/4 percent mortgage indemnity fee. To the extent that up-front expenses to the veteran will actually pay for something of benefit to the veteran, this is a major improvement and, as such, we are cautiously supportive. As we understand it, compensably disabled veterans would be exempt from the indemnification fee even though they would benefit from the protection if affords. We suggest that only those with disabilities in excess of 30 percent should be exempt. We further suggest that a mechanism be built into the legislation which is designed to assist the first time home buying veteran. It is, after all, only these veterans that can be legitimately said to have a readjustment interest in the home loan program. These first-time home buyers should also be exempt from the fee but benefit from its default protection. For second time and subsequent users, perhaps the fee could be either enlarged, require a greater contribution from the government, or be offset by some formula in which those with a proprietary interest in the program pay a portion of the cost.

As difficult politically as this latter alternative may be to accomplish, it certainly deserves serious consideration. This is because, apart from the recession-induced foreclosure rate of the early 1980s, an additional reason for continuing high foreclosure rates is that bankers, builders, realtors and appraisers have had no compelling disincentives from qualifying veterans for properties they cannot afford. These are the parties to the program that, after all, have been able to make handsome profits whether or not the veteran buyer ultimately defaults.

It is understood that in today's real estate market, there have been ever escalating pressures to find creative ways to make housing affordable to middle and moderate income individuals. Property values have skyrocketed out of range for most, at least by contrast with the old rule of thumb holding family mortgage expenditures to 25 percent of net income. To accommodate this pressure, property values have arguably been permitted to escalate artificially in the presence of creative financing mechanisms.

For example, the traditional 30 year mortgage has given way to 40 years. Fixed interest rates have given way to graduated and adjustable rate mortgages. How many more creative methods remain to be developed is an open question, but the apparent goal in each is to find ways of making the unaffordable, affordable. Those who are hurt and will continue to be hurt by these financing methods are the moderate income families and individuals who have no other way into the market but are susceptible to the lure of purchasing unaffordable properties. Whether something needs to be done about this is a question deserving of serious national policy-maker consideration and not just within the veterans community. Additionally, if nothing is done, our tax system will continue to develop wide vistas between a property holding, tax advantaged class and those with no tax advantages.

According to a recent newspaper article in the Washington Post, the latest popular device is equity sharing in which an investor puts up the down payment and closing costs while the inhabitant pays the monthly mortgage. For awhile this may further allow moderate income families to enter the real estate market, but there is no way of knowing for how long.

This is because unaffordable mortgage payments, adjustable rate or otherwise, can be just as unaffordable with or without an investor's down payment.

This statement has digressed somewhat from the generic subject of the veterans home loan program but there is a relationship nevertheless. Today the DVA program continues as a no money down program. However this fact clouds the additional fact that the current rule of thumb is that even without a down payment approximately 5 percent is needed to cover a veterans closing costs. Lacking that amount, it makes little difference whether or not the program has a no down payment feature.

While it is true that this particular feature makes the program more beneficial than the FHA program that requires a down payment, the question remains as to whether we are providing the degree of benefit to veterans that was originally established as a readjustment program benefit many years ago. Because a program is easier to use than another program shouldn't prevent an examination of how the program can be made as beneficial as it can be for those most deserving of readustment assistance.

With this in mind, we encourage the subcommittee to explore ways to make the program easier and less costly to use for first time home buyers and for those veterans with disabilities compensable at a level of over 30 percent.

In conclusion, Mr Chairman, we are supportive of the legislation at hand, albeit reluctantly supportive. Realism, under the current fiscal circumstances, makes it irresponsible to discard the clearly needed remedial approach the proposed measure takes. We do believe, however, that now is time to begin asking some rather searching questions of those with a proprietary interest in the DVA's loan guaranty program. Moreover, we strongly encourage this subcommittee, along with the other housing committees in the Congress as well as the tax writing committees, to take a bold look at where current trends in the real estate market are taking the nation and what the resulting hazards of a continuation of current trends might hold for moderate income taxpayers, veterans and non-veterans alike.

**Mortgage Insurance Companies of America**

Steven P. Doehler
*Executive Vice President*

*April 14, 1989*

*Honorable Harley O. Staggers, Jr.*
*Chairman*
*Subcommittee on Housing and Memorial Affairs*
*335 Cannon House Office Building*
*Washington, DC 20515*

*Dear Mr. Chairman:*

*Thank you for inviting the Mortgage Insurance Companies of America (MICA) to present comments on H.R. 1415, the Veterans Home Mortgage Indemnity Act of 1989, legislation intended to improve the fiscal integrity of the Loan Guaranty Program. The growth of the program's deficiency demands that the government find ways to control program costs. I also will comment as requested on the feasibility of the VA guaranteeing Adjustable Rate Mortgages (ARMs) and provide information based on the loss experience of the private mortgage insurance industry with ARMs and fixed rate loans.*

*MICA consistently has offered support for the veteran's housing entitlement and has attempted to suggest improvements in the guaranty program based upon the business experience of private mortgage insurers. The program is an entitlement and private insurers do not view it as competitive. We mainly have been concerned with the effect of poor program performance on regional mortgage markets. Because of our experience with foreclosure, we understand that the enormous volume of dollars of Loan Guaranty Program losses represent substantial hardship for veteran families. No-bids and other controversial questions would not be an issue if reasonable care was taken to be sure that the program helped veterans acquire homes that remain affordable. The program is seriously flawed when the objective to get veterans into homes is not properly balanced with a concern to keep them in the homes.*

*This legislation proposes to establish a new mortgage indemnity program that will help offset the large subsidy the government has been forced to pay as a result of the poor underwriting of the Loan Guaranty Program. The veteran and the government will pay fees of 1 1/4 and 1/4 percent, respectively, to establish the indemnity fund. It is proposed that the government will bear the liability in the event that losses exceed the reserves of this special trust fund. The program will enable Congress to obtain a more accurate measure of the normal program subsidy cost. Better accountability has important implications for budgeting and determining the cost and effectiveness of government sponsorship of the Loan Guaranty Program. This is a very positive improvement.*

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*I am sure from the review of past experience of the Loan Guaranty Program that the Subcommittee has observed losses do not follow a steady and reasonably predictable pattern from year to year. This is fundamental to the default risk and is true for government and private mortgage insurance. Under favorable economic conditions and with reasonable underwriting by lenders, mortgage insurance losses are likely to be small. However, when localized or regional depressions hit economies, the reserves of an insurer are put under pressure. The timing and duration of such economic downturns are unpredictable.*

*Recognizing the potential for adverse economic cycles was instrumental in the development of the financial structure of the private industry. In addition to case basis reserves for losses, private insurers by law have been required to set up contingency reserves designed to protect against serious economic downturns. A private insurer must establish an amount equal to 50 percent of all premiums earned and hold those funds in reserve for ten years. The existence of this reserve has helped private insurers remain solvent despite the recent period of record high losses.*

*With a funding fee generally around 2 percent, the legislation for the mortgage indemnity program does not appear to take into consideration this true potential level of catastrophic default risk. This amount, based upon current program risk, would, from an actuarial standpoint, possibly be adequate to only cover projected losses that are likely to occur under favorable economic conditions. Based upon the private insurer's experience with default risk, the government, under the proposed funding fee, is likely to be assuming a liability on an ongoing basis of at least another 3 percent or more. The loan guaranty program must take catastrophic risk into account in order to provide a more complete and accurate assessment of the cost to the government. It would be incorrect for Congress to evaluate government cost to be only those from normal losses.*

*Mortgage insurers or the VA must manage default risk or face financial disaster. The private insurers, through MICA and an outside consulting firm, Temple Barker & Sloane (TBS), have developed a historical database to identify trends, perform risk modeling and identify significant risk factors. This database is a powerful tool for managing portfolio risk. With it, a mortgage insurer can individually develop the expertise to do sophisticated underwriting analysis of loan types. This independent and expert third party review of all insured loans ensures financial solvency of the insurer and the protection of lender/policyholders.* Private insurers share risk with lenders and because of this risk sharing, lenders accept the industry's underwriting guides. One product of this risk management partnership between the private insurance industry and lenders is the development and utilization of sensible ARM loans.*

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* *The absence of the independent review and risk sharing in underwriting is an important reason for VA inability to control losses.*

*A key point in understanding ARM loan risk is that combining risk factors multiplies risk. For example, the rate of default based upon the factors of loan-to-value ratio indicates that loans over 90 percent LTV will default three times as often as loans under 90 percent LTV. A conservatively structured ARM loan will default approximately twice as frequently as a fixed rate loan. If you combine the lower downpayment (5 percent vs. 10 percent) and the ARM factor, the rate of default will be greater than six times as high. The more aggressive ARMS that may offer investors more interest rate sensitivity present even greater multiples of default risk.*

*ARM loans pose additional risk especially in more unstable economies and periods when there are rising and volatile interest rates. Since, by design, in stable or falling interest rate environments, ARMS offer no yield advantage, the Subcommittee can reasonably conclude that ARMs are more likely to be offered at times when the lender believes the prospects are greater that interest rates will increase. If the prospects for rate increases are strong, then the prospects for the veteran borrower to see increases in his monthly loan payments are also strong. Increasing monthly payments generally decreases affordability and increases the probability of default. If affordability, not just at origination but throughout loan life, is important to the veteran seeking assistance, the Subcommittee should not support an ARM proposal for VA. This proposal, like opposition to program no-bids that would encourage risk-sharing and better underwriting, asks the question "for whom is the VA program intended to benefit — the lender or the veteran?"*

*As MICA has noted in previous comments to this Subcommittee, a private insurer could not operate without control over the risk it insures. The extreme fiscal deficiencies of the Loan Guaranty Program suggest that perhaps the best way to preserve the housing benefit for the veteran is to consider some significantly different program alternatives and determine how their costs would compare.*

*For example, suppose that the VA were to offer a reduced interest rate loan as a second lien to the veteran who could use the funds to go out into the market and negotiate the best conventional financing arrangement he can. If downpayment is the veteran's problem, he can apply the funds toward the downpayment. If the monthly loan payments are the affordability problem, the veteran could use the funds to buy down (lower) the loan interest rate.*

*The recipient of the loan would receive a housing benefit that would be more valuable than the current "no downpayment" benefit. This idea could also be designed to provide special assistance to those veterans that need a financial benefit longer than the typical veteran borrower. If the typical veteran borrower were to receive a reduced interest rate for a three year period and then pay a market rate for his loan, the special veteran whose income could not yet qualify him to pay a market rate could continue to pay the assisted rate for a longer period.*

*There would also be many positive advantages for the VA from this idea. First, it would be extending assistance to the typical veteran for a three-year period (and in special cases until it was no longer needed), which would replace the VA liability from the guaranteeing of the loan that extends over the term of a loan. Second, by assisting the veteran to enter the conventional market, the VA would not be responsible for the expenses of administering a mortgage*

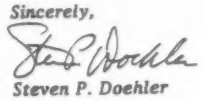
*insurance program (with the no–bid controversy, claims administration, property disposition, etc.). When claims arose, they would be handled between private mortgage insurers and lenders. This would greatly reduce the cost to the VA since its risk would be limited to the second lien. Today, the average VA claim is a substantial percentage of the original loan amount. Third, from a budgetary standpoint, the VA would be able to package these second notes and sell them in the securities market, discounting to reflect the initial reduced rate and making the yield competitive with market rates. The selling of these securities (possibly through GNMA) would be accounted as asset sales and bring in new funds that would reduce the program outlays.*

*Today, many ideas have been put forth in the literature on housing finance that could be applied to assist the veteran. Ideas such as shared appreciation, so that a government program can recapture a part of the benefit of home value appreciation when homes are sold within short time spans, could be used to supply funds to support the program taking on greater risks for veterans with lower incomes. Unfortunately, there are opponents to change that have financial interest in the status quo of the loan guaranty program. They are opposed to improving program efficiency with greater risk sharing and they oppose targeting benefits so that veterans with the greatest needs proportionately get more assistance. Currently, based upon loan size, the veteran with income to qualify him for a larger loan does receive a larger benefit. The VA program data show substantial increases in the median income of borrowers being served. The FHA has had problems with lenders setting minimum loan amounts to discourage lower income borrowers. It would be unfortunate if veterans were experiencing the same problems.*

*The Subcommittee should recognize that there is no shortage of lenders willing to accept financial discipline and to originate high quality conventional loans. One can be confident that these lenders would be willing to implement efficient changes in the veteran's best interest. Private mortgage insurers believe in the importance of serving veterans that really need assistance and we believe that this objective should be achieved efficiently with the minimum cost to the taxpayers. We would be happy to provide what analysis we can to help achieve the goals that Congress will set.*

*I appreciate the opportunity to submit these comments for the Subcommittee's consideration.*

*Sincerely,*



*Steven P. Doehler*

Office of the
Administrator
of Veterans Affairs

Washington DC 20420

Veterans
Administration

JUN 21 1989

Honorable G. V. (Sonny) Montgomery
Chairman, Committee on
Veterans' Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find the Department's responses to questions raised by Representatives Harley Staggers and Dan Burton following the April 18, 1989, hearing on H.R. 1415, the Veterans Home Loan Mortgage Indemnity Act of 1989. A copy of these responses has been provided to Representatives Staggers and Burton.

Sincerely yours,

Edward J. Derwinski
Secretary

Enclosure

cc: Honorable Harley Staggers
Honorable Dan Burton

# WRITTEN COMMITTEE QUESTIONS AND THEIR RESPONSE

Questions for the
Honorable Harley O. Staggers, Jr.
for the Department of Veterans Affairs
April 18, 1989 Hearing

QUESTION: SECTION 4 OF H.R. 1415, WAS DRAFTED IN RESPONSE TO A CASE WHEREBY A VETERAN HAD ONCE USED HIS VA LOAN GUARANTY ENTITLEMENT, REFINANCED CONVENTIONALLY, BUT WAS PRECLUDED FROM USING HIS VA ENTITLEMENT AGAIN TO REFINANCE HIS HOME A THIRD TIME SIMPLY BECAUSE HE HAD NOT DISPOSED OF THE PROPERTY. YOU STATE THAT YOU WOULD SUPPORT THIS PROVISION ONLY IN INTEREST RATE REDUCTION CASES. YET, SUPPOSING HIS CIRCUMSTANCES HAD CHANGED AND HE NEEDED VA FINANCING TODAY TO BUILD AN ADDITION TO HIS HOME BECAUSE HE HAD MORE CHILDREN. IF ANOTHER VETERAN HAD INITIALLY FINANCED CONVENTIONALLY AND WANTED TO USE HIS VA ENTITLEMENT TODAY, HE WOULD BE ABLE TO DO SO. WHY SHOULD WE TREAT THESE TWO VETERANS DIFFERENTLY?

ANSWER: We still believe that the main purpose of the VA home loan benefit is to help veterans purchase a home. The introduction of the interest rate reduction refinancing (IRR) loan was needed to help veterans who obtained loans when interest rates were high to reduce the interest rate and thereby reduce their monthly payments. This not only helps the veteran but makes it a safer investment for the Government. The IRR loan does not involve new entitlement and the veteran may not receive cash from the transaction.

We agree that this same opportunity should be offered to veterans who now have conventional loans. For those veterans who wish a refinancing loan for another purpose, such as that explained in the question, they may receive a regular refinancing loan or "cash out" loan if they have remaining entitlement. This is also the case for veterans who now have VA loans but wish to refinance for a purpose other than just to lower their interest rate.

QUESTIONS SUBMITTED BY
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QUESTION 1: PLEASE DEMONSTRATE WITH A DIRECT COMPARISON USING THE ACTUAL SALES FIGURES AND DEFAULT RATES HOW WITHOUT RECOURSE LOAN SALES RESULT IN MORE MONEY FOR THE GOVERNMENT THAN WITH RECOURSE LOAN SALES:
A) IN IMMEDIATE RETURNS, AND
B) IN THE LONG RUN.

ANSWER: VA has not asserted that non-recourse sales provide greater cash returns to the Government than recourse sales. We elected to proceed with non-recourse sales for American Housing Trusts I, II and III because the total sale value, cash proceeds plus the present value of the estimated future income VA will receive as holder of subordinate certificates, was only slightly below the estimated value of recourse sales and because non-recourse sales provide certain management improvements:

1. Elimination of risk from contingent liabilities inherent in recourse sales;

2. Reallocation of GOE resources for loan servicing and property management of GI loans due to the elimination of future property acquisitions;

3. Competition for procurement of the servicer, resulting in reduced delinquencies and foreclosures; and,

4. More comprehensive loan documentation and management due to the thorough portfolio preparation required for a non-recourse loan sale.

The following table compares the cash proceeds of VA's non-recourse sales with the estimated cash proceeds if the loans had been sold with recourse, and compares the estimated total value of each sale (in thousands). For purposes of comparison all sale proceeds are shown with the account escrow balances netted out, since it has been our practice to charge these funds against the settlement proceeds due VA, rather than transfer them by separate check to the new loan servicer.

NON-RECOURSE LOAN SALES
($000)

| | | |
|---|---|---|
| 6/29/88 | $308,938 | |
| | NON-RECOURSE | RECOURSE |
| CASH Proceeds | $ 173,357 | $ 285,993 |
| Future Income | + 94,535 | |
| Future Costs | | - 8,187 |
| TOTAL | $ 267,892 | $ 277,806 |
| 9/23/88 | $234,347 | |
| | NON-RECOURSE | RECOURSE |
| CASH Proceeds | $ 124,592 | $ 217,793 |
| Future Income | + 83,732 | |
| Future Costs | | - 6,257 |
| TOTAL | $ 208,324 | $ 211,536 |
| 2/23/89 | $278,103 | |
| | NON-RECOURSE | RECOURSE |
| CASH Proceeds | $ 161,361 | $ 252,590 |
| Future Income | + 83,403 | |
| Future Costs | | - 7,425 |
| TOTAL | $ 244,764 | $ 245,165 |

3/23/89 $ 58,134

| | NON-RECOURSE | RECOURSE |
|---|---|---|
| CASH Proceeds | $ 45,219 | $ 44,532 |
| Future Income | NA | |
| Future Costs | | - 76 |
| TOTAL | $ 45,219 | $ 44,456 |

QUESTION 2: WHAT WAS THE FORECLOSURE RATE ASSUMED BY THE PEAT MARWICK STUDY? DID THE DVA ASK DURING THE COURSE OF THE STUDY THAT THE RATE BE REVISED? AND, HOW DOES THE RATE ASSUMED IN THE STUDY, AS REVISED, COMPARE WITH ACTUAL FORECLOSURE RATES FOR EACH OF THE PAST TEN YEARS?

ANSWER: KPMG Peat Marwick originally developed a projected foreclosure rate based on actual VA experience from FY 1980 through FY 1987 (8 years). This analysis produced a 10 year foreclosure rate of 13 percent, with an additional 2 percent foreclosed by the 30th year. VA staff disagreed strongly with this analysis. Our view is that the FY 1980-87 period was not representative of the program's extensive historical experience. During this period the program endured two intense economic shocks. In the early 1980's the country experienced a severe recession which caused a high level of foreclosures in industrial mid-western region of the United States. This was followed by the current economic problems being experienced in Texas and other southwestern states.

Therefore, KPMG Peat Marwick agreed to VA's request to broaden the basis for projection to include a 15 year period from FY 1972-1987. In this manner the lower foreclosure experience of the 1970's would be averaged with the extraordinary circumstances of the 1980s. The calculations lowered the 10 year foreclosure rate to 9.5 percent with an ultimate 30 year foreclosure rate of 11 percent.

The following chart describes home loan foreclosure experience as of September 30, 1988 for all loans guaranteed since the beginning of FY 1972. Please note that the foreclosure rate represents the percent of loans guaranteed in that fiscal year which have been foreclosed.

| FISCAL YEAR | FORECLOSURE RATE |
|---|---|
| 1972 | 4.4% |
| 1973 | 5.0% |
| 1974 | 6.4% |
| 1975 | 5.3% |
| 1976 | 4.3% |
| 1977 | 3.6% |
| 1978 | 4.8% |
| 1979 | 7.4% |
| 1980 | 13.0% |
| 1981 | 19.2% |
| 1982 | 17.5% |
| 1983 | 9.5% |
| 1984 | 11.1% |
| 1985 | 5.7% |
| 1986 | 1.1% |
| 1987 | 0.2% |

QUESTION 3: IS THE DVA AWARE OF ANY PRIVATE SECTOR LOAN SALES AT DISCOUNTS COMPARABLE TO THOSE ON DVA WITHOUT RECOURSE VENDEE LOANS OVER THE PAST SEVERAL YEARS?

ANSWER: The discount on senior certificates which are issued and marketed in connection with VA's non-recourse loan sales is comparable to the discount on securities issued in connection with private sector loan sales of this nature. We are not, however, familiar with any private sector sales through securitized transactions which have entailed such a low

percentage of senior securities as is the case in VA's loan sales. The reason for the high subordination levels in the VA sales is that the loans, which collateralize the securities, are considered to carry a much higher risk than those of private sector loan sellers. This is because VA's loans are geographically concentrated in areas which are experiencing economic difficulties and because most have little or no down payment and are not backed by third-party private mortgage insurance or by any sort of a guaranty on the part of the lender or certificate issuer. We understand there are private sector lenders which, like VA, provide financing to facilitate the sale of properties acquired through foreclosure and therefore may be making loans which have characteristics similar to those in VA's portfolio. To the best of our knowledge, however, none of these lenders deals in a volume of properties comparable to VA and none would have generated enough loans through financing the resale of their properties to make a securitized transaction feasible.

QUESTION 4: PLEASE EXPLAIN THE SYSTEM OF RETAINING "JUNIOR SECURITIES" IN THE DVA RECENT LOAN SALES, WHAT THE PURPOSE OF THE "JUNIOR SECURITIES" IS, AND WHAT THEIR PROJECTED COSTS ARE AS THE RESULT OF FUTURE LOAN DEFAULTS.

ANSWER: VA sells loans without recourse using a securitized transaction. The sole exception to this practice has been our March 23, 1989 sale, in which a large group of older, well-seasoned, loans for which there is a strong competitive market were auctioned. In a securitized transaction, VA transfers the loans to a Trust which, in turn, issues securities which are collateralized by the loans. Two types of securities are issued, senior and subordinate (or, "junior"). The senior securities are sold in the open market and VA receives the proceeds of sale plus the subordinate securities as payment for the loans. As the borrowers on the loans make their installment payments, the funds received are collected and paid out, once a month, to the holders of the securities.

In a securitized transaction with this structure, the funds received each month are paid out on prioritized basis. The holders of the senior securities receive their share of the funds first, and the remaining balance is paid to the holders of the subordinate securities. This provides the holders of the senior securities with assurance that they will receive a certain income each month from their investment. This assurance is necessary in order to give an investment grade rating to the senior securities and to induce investors to purchase them at prices which are appropriate for their rating.

The subordinate securities are considered to represent a much riskier investment than the senior securities because, to the extent that borrowers default on their payments and loans are foreclosed, the amount of income which the Trust receives each month for distribution to securities holders is reduced. The holders of subordinate securities receive reduced payments whenever such shortfalls occur.

VA has retained the subordinate securities from the first three non-recourse sales because, due to the perceived risk of holding such securities, it is unlikely they could be sold to investors except at a substantial discount from their face value. There are, however, no projected costs to VA which can result from holding these certificates in the event of future defaults. The only effect of such defaults is to reduce the amount of income VA would otherwise receive as certificate holder. In placing a value on these certificates, VA has already taken an estimated impact of future defaults into account. The certificates are valued on the assumption that the default and foreclosure experience on the loans will be

comparable to that on vendee loans VA has sold subject to repurchase agreements in the past. If the loans perform better or less well than expected, VA's income will be greater or lower than projected.

QUESTION 5: WHY DOES A CONTINGENT LIABILITY IN THE FORM OF A VENDEE LOAN SOLD WITH RECOURSE RUN COUNTER TO EFFECTIVE DEBT MANAGEMENT?

ANSWER: When vendee loans are sold with recourse, VA incurs a substantially greater future liability than when they are sold without recourse. Recourse sales provide essentially unlimited liability--every loan sold is subject to repurchase in the event of serious default and VA assumes full responsibility for servicing, foreclosure and resale of property acquired after repurchase. On the other hand, with non-recourse sales VA's future involvement with the loans is limited to the amount of income received each month from the subordinate securities it receives as partial proceeds of the loan sales.

We believe that the subordinate securities represent a contingent asset to the government that is preferable to an unlimited liability attributable to recourse sales. Notwithstanding the historic default rate associated with recourse sales, there is no guaranty on the number of repurchases which will have to be made in the future. Although we can only speculate on the magnitude of our current liability due to years of selling loans with recourse, it is a fact that the American Housing Trusts I, II and III have resulted in a liability-avoidance of $.9 billion.

Through the use of non-recourse sales, VA has converted a loan sale procedure which entailed unlimited future liability to a procedure which avoids such liability altogether while providing the Government with valuable contingent assets. Given a choice between these two procedures, effective debt management dictates selection of the procedure which minimizes future risk of loss and facilitates more accurate budget and workload planning.

QUESTION 6: WILL THE DVA's PROPOSED "VETERANS' HOUSING AMENDMENTS ACT OF 1989" GET THE HOME GUARANTEE PROGRAM BACK ON ITS FEET FINANCIALLY? IF SO, PLEASE EXPLAIN HOW.

ANSWER: The Veterans' Housing Amendments Act of 1989 has two provisions that will contribute significantly towards financial stability in the Loan Guaranty Program. This proposal calls for extending through FY 1991 the funding fee charged to veterans. We estimate that a total of $286 million in additional revenue will be collected over the next two fiscal years. Secondly, VA proposes legislation to allow the Secretary to continue to sell vendee loans without recourse. As the law currently stands, VA would be prohibited from selling loans without recourse unless they could be sold at par. The proposed change would result in budget authority savings of over $3 billion during FY 1990-1994.

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